THE AMERICAN ENERGY INITIATIVE, PART 16: A FOCUS ON RISING GASOLINE PRICES

HEARING

BEFORE THE

SUBCOMMITTEE ON ENERGY AND POWER

OF THE

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WITNESSES

SUBMITTED MATERIAL

THE AMERICAN ENERGY INITIATIVE, PART 16: A FOCUS ON RISING GASOLINE PRICES

WEDNESDAY, MARCH 7, 2012

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON ENERGY AND POWER,
COMMITTEE ON ENERGY AND COMMERCE,
Washington, DC.

The subcommittee met, pursuant to call, at 10:37 a.m., in room 2322 of the Rayburn House Office Building, Hon. Ed Whitfield (chairman of the subcommittee) presiding.

Members present: Representatives Whitfield, Sullivan, Shimkus, Terry, Burgess, Bilbray, Scalise, McMorris Rodgers, Olson, McKinley, Gardner, Pompeo, Griffith, Barton, Upton (ex officio), Rush, Castor, Markey, Engel, Green, Capps, Doyle, Gonzalez, and Waxman (ex officio).

Staff present: Anita Bradley, Senior Policy Advisor to Chairman Emeritus; Maryam Brown, Chief Counsel, Energy and Power; Allison Busbee, Legislative Clerk; Garrett Golding, Professional Staff Member, Energy and Power; Cory Hicks, Policy Coordinator, Energy and Power; Ben Lieberman, Counsel, Energy and Power; Phil Barnett, Democratic Staff Director; Alison Cassady, Democratic Senior Professional Staff Member; Greg Dotson, Democratic Energy and Environment Staff Director; Caitlin Haberman, Democratic Policy Analyst; and Alexandra Teitz, Democratic Senior Counsel, Environment and Energy.

Mr. WHITFIELD. I want to thank you all, those of you who are testifying today, we appreciate you being here. We are going to wait just a few minutes for our Ranking Member, Mr. Rush, and then we will get started with this hearing.

OPENING STATEMENT OF HON. ED WHITFIELD, A REPRESENTATIVE IN CONGRESS FROM THE COMMONWEALTH OF KENTUCKY

I am going to call this hearing to order, and once again I want to thank the witnesses for being here today. We look forward to your testimony. I am delighted that our referees are back with us today. They have attended a few of our hearings, and it is always good to have referees here to make sure that everyone presents a balanced view. And we welcome the rest of you as well.

Today, we are going to focus on increasing gas prices, an issue that has an impact on the pocketbook of practically every American. When President Obama took office, the average gasoline price was around $1.85 a gallon, and today it is over $3.60 per gallon. Now, I do not intend today to place all of the blame on the Presi-

dent, but I am going to give him some blame. But I think the facts clearly show that if we continue to follow his policies, gas prices are not going to go down, they are going to go up.

Now, the President's supporters like to say, and they are correct, that oil production is up in the U.S. since President Obama became the President, but it is important to recognize that the increase in production is due to production on private and State lands, the Bakken Field being a prominent example of that. In fact, oil production is down on Federal lands, and that is what the President has control of. In fact, one of the President's first initiatives in 2009 was to cancel oil leases on Federal lands and to delay the offshore leasing program, and he cancelled five offshore leases even before the Horizon—Deepwater Horizon incident. I might also say that when he became president, offshore drilling was possible in the Atlantic and in the Pacific. Today it is not.

In a speech at the University of Miami a few weeks ago, in the wake of criticism for denying the permit to build Keystone, the President said he has approved dozens of new pipelines. Well, presidential permits are applicable only on international pipelines, and since he has been President, only one has come before him for approval, and that has been Keystone and he denied that.

The President and his administration have decided to address energy costs by spending billions of taxpayer dollars to develop electric cars. They have raised the CAFE standards, which is fine, and they are imposing more regulations instead of encouraging production of our domestic resources. They are putting regulations on refineries and they are encouraging—discouraging production, as I said.

For example, GM received millions of dollars and they curtailed the production of the Volt automobile because sales are lagging. Tesla and Fisker, both recipients of Federal taxpayer dollars, have curtailed production primarily because Americans cannot afford to buy an automobile that costs around $100,000.

Now, we all recognize that it is important to improve the mileage of automobiles, and so CAFE standards are important, but it is also important to recognize that it does raise the cost of cars. EPA itself said that by the year 2016, cars are going to increase by $1,000 and by 2025, they are going to increase by $3,000. So rather than trying to reduce the cost of existing regulations by EPA, they are considering adding more regulations, such as new source performance standards targeting greenhouse gas emissions from refineries and new Tier 3 regulations.

So I think there is a clear contrast here. This administration is looking way, way, way into the future, which is important, but we need some immediate assistance and the best way to go on that avenue to address this need is to make production of our domestic resources more available to the American people.

[The prepared statement of Mr. Whitfield follows:]

Opening Statement of the Honorable Ed Whitfield
Subcommittee on Energy and Power
Hearing on "The American Energy Initiative:
A Focus on Rising Gasoline Prices"
March 7, 2012

Today's hearing, another installment of the "American Energy Initiative," allows us to discuss the topic of rising gasoline prices.

Pump prices have risen sharply over the past three months from $3.35 a gallon the week of December 5 to $3.85 a gallon this week.

High gasoline prices hit the pocketbook of every business, family, and consumer. To make matters worse, with an economy struggling to create jobs and new income, rising gas prices equate to a tax on everyone.

The latest surge offers an opportunity to take a look at what is happening in oil and gasoline markets as well as what the federal government can do to help moderate high prices.

With every gas price spike comes some very familiar calls from policymakers. Some argue for increased domestic drilling, some say we should release oil from the Strategic Petroleum Reserve. Others lay the blame for high prices on Wall Street and the oil companies.

Before we discuss the merits of these causes and solutions, let's start with the facts. First, Iran has threatened to block the Strait of Hormuz – a narrow channel in the Middle East through which a third of the world's waterborne crude oil passes every single day. As a result, a geopolitical risk premium is being priced into every barrel of oil. Until the situation with Iran is resolved, and hopefully that is soon, we will see above-average oil and gasoline prices.

Second, in addition to geopolitical tensions and their effect on oil prices, fundamental supply and demand is creating an environment of high prices. There is large demand growth from China, India, the Middle East, and Brazil. At the same time, current supplies are not growing at rate that can keep up with surging demand from these economies. That is why countries like Brazil and China are moving forward with aggressive oil production plans at home and abroad.

Third, North America's oil market has undergone a dramatic transformation over the past five years. We are now producing over 500,000 barrels per day in North Dakota. In 2005, that number was below 100,000. In Texas, oil production has increased 50 percent in just four years. Like the natural gas revolution, North America is now experiencing its own oil boom.

Oil production is surging in this country in no thanks to the Obama administration. All the new volumes coming online are happening on private- and state-owned lands. Production is declining at an alarming rate on federal lands and waters. There is a lot more that can be done if the federal government would simply get out of the way.

With this development in mind, it is important to examine what President Obama says about oil production in this country. The president has proclaimed we have only two percent of the world's proven oil reserves and we can't drill our way to energy security. But if you know

what a proven oil reserve is, you would realize America's energy potential is nearly unlimited.

A proven oil reserve is a figure that is obtained by an oil producer once they have fully explored and developed an oil field. Using the president's definition, the U.S. has 28.4 billion barrels of oil. That equates to two percent of the world's oil. But if you look at all the untapped resources, the U.S. holds trillions of barrels of oil. The Obama administration says we have only two percent of the world's oil because that's all they will let us have.

Today we have the opportunity to examine these facts and their impact on prices at the pump. We hope to gain a better understanding of how energy production and consumption in this country can be improved to help insulate ourselves from supply disruptions halfway around the world.

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Mr. WHITFIELD. At this time, I would like to recognize the gentleman from Illinois, Mr. Rush, for 5-minute opening statement.

OPENING STATEMENT OF HON. BOBBY L. RUSH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Mr. RUSH. I want to thank you, Mr. Chairman.

Mr. Chairman, we all know that gas prices are set on the global market and there are a variety of real political factors that determine the price of fuel, many of which are beyond the control of the much-maligned President of which you speak, or this Congress, which in the last 2 years has been basically described as a "do nothing" Congress.

But there are some factors that we do not have control over, including the role of speculators in setting fuel prices.

Mr. Chairman, while we understand that speculation plays a significant role in setting gas prices, it is very difficult to get a clear answer on how big a role speculators actually play. That is why on March 1, I sent a letter to the Chairman Gensler, who is the Chairman of the Commodities and Futures Trading Commission, the CFTC, asking him to conduct an investigation into the practices of Wall Street traders, and also to examine how much of an impact these speculators actually have on increasing gas prices. Additionally, on Friday I entered my name to a bicameral letter to the CFTC, calling for strict position limits on all futures contracts in order to eliminate excessive speculation. In fact, Mr. Chairman, I believe it would benefit this subcommittee to hold a hearing strictly on this issue, in order to bring transparency to the American people so that we all can better understand the role that speculators play in raising fuel prices.

In an ABC News article entitled "How Wall Street is Raising the Price of Gas" dated February 23, 2012, one CFT commissioner estimate that speculators do indeed contribute significantly to raising fuel prices. Commissioner Chilton estimated that Wall Street speculators raised the price an additional $7 to $14 every time a consumer fills up the tank, depending on the size of the car

While industry groups dispute these figures, I think it would behoove us all to shed some light on this issue in order to bring transparency and help the American consumer better understand this relationship between the speculators and rising fuel prices and raising fuel prices also. And while some may argue that rising fuel prices are simply a matter of supply and demand, today's sharp increases are happening at a time when under President Obama we are producing more oil than at any time in our history. We are importing less oil than at any time in the past 13 years, and the American demand for oil is actually lower than it was a year ago.

Now you take that and think on those facts. An article by "The Washington Post" with Bloomberg Business entitled gas prices rise for the 27th straight day, oil recovers late to close above $107 a barrel, dated February 29, 2012, Washington Post and Bloomberg business both reported that Americans were paying an average of $3.73 cents a gallon for regular gasoline, which is 30 cents higher than it was just last month, and 36 cents higher than it had been at this time last year. At the same time, the Department of Energy

recently reported that average demand has actually dropped 6.7 percent as compared to nearly the same time last year.

So Mr. Chairman, I am not blaming speculators for these sharp increases in gas prices, but I do believe it is worth examining this issue more closely to better understand the role that speculation played in impacting the price at the pump.

Mr. Chairman, with that I yield back the remaining time that I might have.

Mr. WHITFIELD. Thank you, Mr. Rush.

At this time I would like to recognize the chairman of the full committee, Mr. Upton, from Michigan for a 5-minute opening statement.

OPENING STATEMENT OF HON. FRED UPTON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN

Mr. UPTON. Thank you, Mr. Chairman.

Let us face it. There are many factors that contribute to the high price of gas. Some, like Middle East instability and rising global demand, are largely outside of the Federal Government's control. For that reason, it is absolutely critical to get right those things that we can control. None of America's pain at the pump should be self-inflicted, which is why we need to do more to increase domestic and North American oil supply, and to streamline the Federal regulatory burden on gas.

At last weekend in my district, gas prices averaged 3.99 a gallon. Though the President has begun to say some of the right things about high gas prices, he continues to do all the wrong things as well. In fact, the President's approach has not changed since he took office in January of 2009. Gas was about $1.85 a gallon back then, and one of the President's first initiatives before Deepwater Horizon was to cancel many of the oil leases on Federal lands. And his 2012 to 2017 offshore leasing plan re-imposes the moratorium that Congress and the White House lifted back in 2008. But the administration's hostility towards domestic drilling has not changed, only the rhetoric has. The President now boasts that domestic drilling is up, but he neglects to mention that the increase is due to the production on private and State-owned lands where Federal regulators have little or no power to block drilling. Production actually declined on Federal lands from 2010 to 2011, and the administration has offered up no policy changes that would reverse that disturbing trend.

Some in D.C. claim that producing more domestic oil won't make any difference in prices, but the American people know better. American people also know that when it comes to Keystone XL pipeline expansion, they would allow more Canadian oil to reach the American market is a good thing. Compare the rejection of Keystone to something that the President did approve last June, tapping SPR for 30 million barrels. However, SPR is not a new supply of oil, it is a stockpile previously set aside for an emergency, and it can only be tapped for a short while and then would need to be replenished, which the President hasn't, by the way. In contrast, Keystone would represent a genuine addition to our Nation's oil supply, and one that would last for decades rather than months.

Rarely has the contrast between a real solution and a gimmick been more clear than this pipeline and SPR.

So some may scratch their heads and pretend that the closure of several East Coast refineries is some kind of mystery, but it is no mystery to me that existing and anticipated future regulatory costs are a key contributor. At the very least, we need to hold the line against additional regulations likely to raise the cost of producing gasoline.

[The prepared statement of Mr. Upton follows:]

Opening Statement of the Honorable Fred Upton
Subcommittee on Energy and Power
Hearing on "The American Energy Initiative:
A Focus on Rising Gasoline Prices"
March 7, 2012

Many factors contribute to the high price of gasoline. Some, like Middle East instability and rising global demand, are largely outside of the federal government's control. For that reason, it is absolutely critical to get right those things that we can control. None of America's pain at the pump should be self-inflicted, which is why we must do more to increase domestic and North American oil supplies, and to streamline the federal regulatory burden on gasoline.

With prices zeroing in on $4.00 a gallon, President Obama has begun to say some of the right things about high gas prices. But he continues to do all of the wrong things. In fact, the president's approach has not changed since he took office in January of 2009. Gas was around $1.85 per gallon back then, and one of the president's very first initiatives, before Deepwater Horizon, was to cancel many oil leases on federal lands. And his 2012-2017 Offshore Leasing Plan re-imposes the moratorium that Congress and the White House lifted back in 2008. So much for that progress.

The administration's hostility towards domestic drilling has not changed, only his rhetoric has. The president now boasts that domestic drilling is up - but he neglects to mention that the increase is due to production on private and state-owned lands where federal regulators have little to no power to block drilling. Production actually declined on federal lands from 2010 to 2011, and the administration has offered up no policy changes that would reverse this disturbing trend.

Some in Washington claim that producing more domestic oil won't make any difference in prices, but the American people know better. The American people also know better when it comes to the Keystone XL pipeline expansion project that would allow more Canadian oil to reach American market.

Compare the rejection of Keystone XL to something the president did approve last June - tapping the Strategic Petroleum Reserve for 30 million barrels. However, the SPR is not a new supply of oil, it is a stockpile previously set aside for an emergency. And it can only be tapped for a short while, and then would need to replenished – which the president hasn't by the way. In contrast, Keystone XL would represent a genuine addition to our nation's oil supply, and one that would last for decades rather than months. Rarely has the contrast between a real solution and a gimmick been more clear than between Keystone XL and the SPR.

The president also said many of the right things about regulatory reform in his Executive Order 13563, entitled "Improving Regulation and Regulatory Review." His directive that federal agencies carefully scrutinize the cost of any new regulations while streamlining or repealing existing ones would be a great policy to apply to gasoline-related measures. But it has not happened.

In the year since this Executive Order was issued, there has been virtually no effort to try to reduce the regulatory burden that raises the cost of refining oil into gasoline. Instead, the administration is hard at work piling costly new measures on top of the existing ones,

including upcoming Tier 3 gasoline regulations and New Source Performance standards targeting greenhouse gases from refineries.

Some may scratch their heads and pretend that the closure of several East Coast refineries is some kind of mystery. But it is no mystery to me that existing and anticipated future regulatory costs are a key contributor. At the very least, we need to hold the line against additional regulations likely to raise the cost of producing gasoline.

As an added bonus, the things we can and should be doing to help bring down gasoline prices – like increasing North American oil supplies and streamlining the regulatory burden – also happen to create jobs. On the other hand, pursuing non-solutions like tax increases or tapping the SPR won't solve our need for energy or for jobs. In any event, I look forward to working on any proposals likely to give the American people a break at the pump.

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Mr. UPTON. I would yield the balance of my time to Mr. Barton.

OPENING STATEMENT OF HON. JOE BARTON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. BARTON. Mr. Chairman, thank you for yielding. Let me simply say that Chairman Upton has just pointed out, gasoline prices are going up. He said it was 3.99 a gallon in Michigan, and in my hometown of Ennis, Texas, it was 3.58 a gallon, so come to Texas and you will save 40 cents.

But that is still quite a bit more than it was when President Obama became President. It was $1.80 a gallon 3 years ago. For every penny a gallon, that is $1.4 million a day—billion? Is it billion or million? Billion, OK. If the chairman says billion, I am going to go with billion. But I am talking on an annual basis, that is about $262 billion a year, and that is too much.

So we look forward to hearing from our witnesses what we can do to get prices down. I think it is obvious that part of the solution is to drill more here in the United States. If you are going to drill more, you need regulatory relief. You need to use hydraulic fracturing for oil like we have been doing for natural gas, and I think we can do that.

Mr. BARTON. And with that, I will yield to——

Mr. SHIMKUS. You would rather yield to him than me.

Mr. BARTON. I have to yield to seniority. Mr. Shimkus.

OPENING STATEMENT OF HON. JOHN SHIMKUS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Mr. SHIMKUS. I will try to go quick, thank you. Because I want to ask questions, I want to get a few points off. The renewable fuels standard which we passed, and really, it was supported by both sides of the aisle, has been very, very successful. Ten percent of our Nation's gasoline supply is now through renewable fuels. You know, just talking about the mixing of E–10 or E–15, that is lowering the rate, and we have to remember that the tax credit is gone. So for my colleagues who don't like this, we don't have a blenders tax credit anymore, and it is still competitive and it is a source of success. A gallon of ethanol is currently selling for nearly a dollar less per gallon than a gallon of gasoline. American oil demands have decreased, and national import dependence has fallen from 60 percent to 45 percent.

And I will end and yield—I don't have much time, Doc, so ethanol provides gasoline refiners with a cost effective source of octane with an octane rating of 113. Research octane number.

I apologize, Dr. Burgess. I yield back my time.

Mr. WHITFIELD. Gentleman's time is expired.

At this time I recognize the gentleman from California, Mr. Waxman, for a 5-minute opening statement.

OPENING STATEMENT OF HON. HENRY A. WAXMAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. WAXMAN. Mr. Chairman, today this subcommittee examines the issue of rising gasoline prices.

We have seen this movie over and over again for the last 30 years. Gasoline prices go up, politicians make false promises about how they will bring prices down, and nothing gets accomplished.

We have seen it with the push to open our coastlines to more drilling. There is no moratorium. In fact, 74 percent of the coastline is now being leased for drilling, primarily in the Gulf of Mexico, unlike the statements we have heard so far. We have seen it with the enactment of legislation to promote refineries in 2005. Still prices rise.

Now the Republican mantra is that we need to "drill, baby, drill." This slogan may sound good, but it is based on a complete fiction.

We are drilling more, but prices are still going up. U.S. crude oil production is the highest it has been in 8 years, and the U.S. has more oil and gas drilling rigs operating right now than the rest of the world combined. Net oil imports as a share of our total consumption declined from 57 percent in 2008 to 45 percent in 2011, the lowest level since 1995.

We need to face reality, and the reality is that oil prices are determined on a global market. Now matter how much we drill, our gasoline prices are going to rise if there is a crisis in the Middle East, labor unrest in Nigeria, or any of a host of other factors we can do little about.

There is only one way we can protect ourselves from the impacts of rising oil prices: We need to reduce our dependence on oil.

There are no short-term solutions. There is no silver bullet. The effects of a short—of releasing oil from the SPR could be short-term, as it has in the past, if we are working with other countries to accomplish that goal. We need to invest in clean energy to diversify and reduce our energy use.

The President has taken important steps. He has acted to cut the emissions of cars and trucks, doubling the fuel efficiency of our fleet. As a result, our dependence on oil has declined. But he needs our help. Oil companies are making record profits, yet they are still getting $4 billion in subsidies from taxpayers each year.

We can't afford to take money from taxpayers struggling to pay their mortgages and fill up their tanks and hand it to oil companies making billions in profits. That is why we need to repeal the oil subsidies and use the money to develop sources of clean energy that reduce our dependence on oil.

Today, we are going to hear a lot of the same old unsupported claims. The American Petroleum Institute will tell us that we can bring down global oil prices by drilling more in the United States. That is the line we are hearing from the Republicans.

The refiners will tell us to help consumers, we need to send a "message to the market" by producing more oil in the United States.

The National Association of Convenience Stores will say that making "an announcement of a long-term commitment by the United States to increase its contributions to the international crude oil market could help calm some of the inflationary influences in the futures market."

These claims have no foundation in reality. My staff contacted some of the Nation's leading energy economists. They told us that

the so-called solutions we will hear today from the oil industry will not reduce our gasoline prices.

John Parsons, an economist at MIT, one of the Nation's leading experts on the oil markets, told us "that the industry claims are not remotely plausible" because drilling more will have "at best a miniscule impact on gasoline prices."

Oil industry expert Phil Verleger told us that announcing more production would have "no impact, zero, on the current price." He predicted that the people who buy or sell oil would simply ridicule these recommendations as a plan for reducing gasoline prices.

The President said it best when he said, "Anyone who tells you we can drill our way out of this problem doesn't know what he or she is talking about, or isn't telling you the truth."

This committee has a responsibility to set the Nation's energy policy. We should start by facing facts, listening to experts, and crafting policies that would reduce our dependence on oil.

Yield back my time.

Mr. WHITFIELD. Gentleman's time is expired. That concludes the opening statements, and so at this time I would like to introduce our witnesses this morning.

First we have Mr. Robert McNally, President of the Rapidan Group. We appreciate your being here. We have Mr. Jack Gerard, President and CEO, American Petroleum Institute. We have Mr. Charles Drevna, President, American Fuel and Petrochemical Manufacturers. We have Mr. Chris Milburn, owner of CarbM Trucking. We have Mr. Daniel Weiss, Senior Fellow, Center for American Progress, and we have Mr. Michael Breen, Vice President, Truman National Security Project, and we have Mr. John Eichberger, Vice President of Government Relations, NACS. We appreciate all of your being here and we look forward to your testimony on this very important subject of increased gasoline prices.

So I am going to be calling, beginning with Mr. McNally, on each one of you and you will be recognized for 5 minutes for your opening statement. There is a little instrument there on the table and when your time is up, it will say red. It will be red, so that means your time is up.

So Mr. McNally, we look forward to your testimony and I recognize you for 5 minutes.

STATEMENTS OF ROBERT MCNALLY, PRESIDENT, THE RAPIDAN GROUP; JACK N. GERARD, PRESIDENT AND CHIEF EXECUTIVE OFFICER, AMERICAN PETROLEUM INSTITUTE; CHARLES DREVNA, PRESIDENT, AMERICAN FUEL AND PETROCHEMICAL MANUFACTURERS; CHRIS MILBURN, MEMBER, OWNER-OPERATOR INDEPENDENT DRIVERS ASSOCIATION; DANIEL J. WEISS, SENIOR FELLOW AND DIRECTOR OF CLIMATE POLICY, CENTER FOR AMERICAN PROGRESS; MICHAEL BREEN, VICE PRESIDENT, TRUMAN NATIONAL SECURITY PROJECT; AND JOHN EICHBERGER, VICE PRESIDENT, GOVERNMENT RELATIONS, NATIONAL ASSOCIATION OF CONVENIENCE STORES

STATEMENT OF ROBERT MCNALLY

Mr. MCNALLY. Chairman Whitfield, Ranking Member Rush, members of the committee, thank you for the opportunity to testify to you today. I have spent the bulk of my career analyzing energy, oil markets, and economic policymaking, and served on the White House National Economic Council and National Security Council between 2001 and 2003. I am an independent analyst. I do not represent any entity, and the views I express here today are my own.

The subject is rising gas prices, but let us step back and note, this is the sixth big run up in gasoline prices in 7 years. For most Americans, from the 1970s until about 2005, following the price of gasoline was like riding the Disney World ride It's a Small World: shifting, but basically an unremarkable experience. Since 2005, it has felt more like Space Mountain: unpredictable, scary, gut-wrenchingly volatile. This ride is no fun for our families and for our businesses. They are confused and angry and deserve to know why prices have been rising and gyrating so much.

Let me come right to the point. Gasoline prices are rising mainly because crude oil prices are rising. Crude oil accounts for over 2/3 of the cost of retail gasoline. So far this year, crude oil is up 14 percent, gasoline prices are up 16 percent. Crude oil prices are rising because the global market in which they are formed is tight. Official data reports show that global demand is at historic highs and still soaring, supply has been disappointingly small, commercial inventories outside the United States are low, supply interruptions have occurred, OPEC's spare capacity is much lower than officially estimated just months ago. On top of that, this year a rash of refinery closures in the Northeast, the U.S. Virgin Islands, and Europe, and tension surrounding Iran's nuclear program are contributing to high gasoline oil price strength, respectively.

It is crucial to understand that oil prices naturally gyrate sharply when demand and supply are unbalanced. To suppress this national volatility, throughout history oil producers have held back production in spare, called spare capacity. Spare capacity is held back from fields that can be quickly tapped to act as a shock absorber when demand is strong or disruptions occur to avoid the need for wild price swings. Since the 1980s, OPEC has used spare capacity to stabilize prices, but over the last 7 years, OPEC's spare capacity has eroded and they can no longer do the job. The reason is a mix of veracious, relentless oil demand growth in fast-growing Asia and the Middle East on the one hand, and disappointingly

small net oil production oil growth on the other. While experts differ, many see this strong demand, weak supply, tight spare production capacity lasting for the foreseeable future. If so, crude oil prices will continue gyrating wildly, and as go crude oil prices, so go gasoline prices.

As many have said, there is no silver bullet or short-term solution for our predicament. Using the Strategic Petroleum Reserve to smooth gasoline prices, absent a severe supply disruption, would be deeply unwise and counterproductive. The SPR and the Department of Energy are not well-suited to stabilizing global oil prices. Reserves are too small relative to market flows, information is too poor, and SPR interventions would be politicized. If Washington sold SPR oil every time gasoline prices rise, we will end up with no SPR, more volatile prices, and less protection against supply interruptions.

Now 7 years into the Space Mountain era of gasoline prices, it is time to get beyond the blame games and on with solutions. Yes, OPEC, oil companies, investors, EPA, consumers, geopolitical trends and events, central banks, poor data, subsidies, all these factors have and will play a role in the world's enormous and complicated oil market. But the real reason for gyrating oil prices is a tidal wave of new demand outside the United States that is colliding against an oil industry struggling to increase oil supply enough to meet it. These are iron laws of economics, and we will have to live with them. It is past time to enact easy, common-sense steps like improving data or bolder ones, such as vastly increasing domestic and international energy supply, moderating demand, strengthening our resilience to oil price gyrations. We should act quickly and resolutely as if our jobs, our standard of living, and national security depended on our success. Taking counsel from President Lincoln, who said in regard to a different crisis "The dogmas of the quiet past are inadequate for the stormy present. The occasion is piled high with difficulty. We must rise to the occasion. As our case is new, so must we think anew and act anew."

Thank you.

[The prepared statement of Mr. McNally follows:]

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"Space Mountain" Pump Prices

Testimony of Robert McNally
President, The Rapidan Group
Subcommittee on Energy and Power of the House Committee on Energy and Commerce
"The American Energy Initiative"
March 7, 2012

Chairman Whitfield, Ranking Member Rush, members of the Committee, thank you for the opportunity to provide testimony to you on the American Energy Initiative. I appreciate your calling this hearing on the crucial topic of rising gasoline prices, and I am honored that you have asked me to share my perspective and views.

I approach this subject with twenty-one years of professional experience analyzing and participating in energy markets and policymaking. I have spent the bulk of my career analyzing the global oil market, energy, and economic policymaking. I also served as Special Assistant to the President for Economic Policy on the White House National Economic Council from January 2001 to June 2003 and Senior Director for International Energy on the National Security Council from January 2003 to June 2003. I am currently an independent analyst and do not represent any entity. The views expressed here are entirely my own.

The subject of today's hearing is rising gasoline prices, which hurt family budgets and imperil our economic recovery. Before evaluating the factors that contribute to the most recent rise, it is worth considering that gasoline price upswings are becoming more frequent and consumers are wondering why this is the case. As Michael Levi and I wrote last summer in Foreign Affairs[1]:

> For most Americans, from the late 1970s until just a few years ago, following the price of gasoline was like riding the Disney World attraction It's a Small World: a shifting but gentle, basically unremarkable, experience. But since 2005, it has felt more like Space Mountain--unpredictable, scary, gut-wrenchingly volatile. Between January 2007 and July 2008, the price of a barrel of oil rose from $50 to more than $140; by the end of 2008, it had crashed to just over $30; less than a year later, it had breached $80 again. In early 2011, on the back of strong global demand and the political turmoil in the Middle East and North Africa, oil sold for over $120 a barrel. Today, as prices continue to swing wildly, most Americans are wondering why they are on this ride and how to get off.

In March of 2012 we find ourselves again on the upswing, with pump prices at all-time highs for this time of year. Gasoline prices are rising mainly because crude oil prices are rising, though the shutdown of refinery capacity in the US, Europe, and Caribbean will also play a role.

Crude oil prices are rising mainly because of global supply and demand fundamentals, which are tight, especially outside the United States, as well as actual and threatened geopolitical disruption risks. OPEC spare capacity, almost entirely held in Saudi Arabia and which in the past has been used to stabilize global oil prices and reassure market participants that geopolitical disruptions could be offset, has been and will likely remain too low to do so.

Unfortunately, there are no effective policy options to counter the short term crude and gasoline price volatility caused by a fundamentally tight and fearful global oil market. Using the strategic petroleum reserve to counter short term price volatility absent a severe supply interruption could not only be irresponsible but also counterproductive.

There are policies that can reduce future price volatility and enable our consumers to adjust to it in the medium and longer term. They range from improving the quality of data in order to reduce the uncertainty that contributes to volatility to improving the funding and focus of energy-related research and development. A crucial step is to increase oil supply everywhere: In a tight market and especially when spare capacity is otherwise low, every extra barrel of supply on the margin counts and can help reduce future price volatility. If North America succeeds at increasing oil supply by some 6 mb/d or more, then it would free up more Middle East oil to go to Asia or remain in spare capacity to offset a disruption.

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1. "Crude Predicament: The Era of Volatile Oil Prices," Foreign Affairs, July/August, 2011, see attachment.

I would like to now elaborate on some of these points.

Current rising gasoline prices are due to tight global supply demand fundamentals and geopolitical risk

Gasoline prices have risen in tandem with global crude prices, reflecting the fact, as EIA has noted, that "[t]he single biggest factor in the price of gasoline is the cost of the crude oil from which it is made."[2] So far this year, Brent crude prices are up 14%, NY wholesale gasoline prices are up 16%, and retail gasoline prices are up 14%.[3] US wholesale gasoline prices reflected in spot month futures contract prices are up 16-19%.

Crude price increases, as the Energy Information Administration (EIA) recently noted, are mainly due to unexpected tightening in global supply demand fundamentals, lower than expected OPEC spare capacity, and considerable geopolitical disruptions and disruption risk, especially related to Iran. Citing from EIA's February 29 report:[4]

> EIA estimates that the world oil market has become increasingly tight over the first two months of this year. Oil prices have risen since the beginning of the year and are currently at a high level. Global liquid fuels consumption is at historically high levels. While the economic outlook, especially in Europe, remains uncertain, continued growth is expected. Unusually cold weather in Europe contributed to tighter markets by increasing the demand for heating oil, particularly during February.
>
> With respect to supply, the world has experienced a number of supply interruptions in the last two months, including production drops in South Sudan, Syria, Yemen, and the North Sea. Both the United States and the European Union (EU) have acted to tighten sanctions against Iran, including measures with both immediate and future effective dates. There is some evidence that these measures may already be causing some adjustments in oil supply patterns. For example, there is emerging evidence that some shipments of Iranian crude oil under existing contracts are being curtailed due to the unwillingness of U.S. and EU insurance providers to cover them, even though the EU sanctions only require existing oil contracts to be completely phased out by July 1, 2012.
>
> Finally, spare crude oil production capacity, while estimated to be higher than during the 2003 to 2008 period, is quite modest by historical standards, especially when measured as a percentage of global oil production and considered in the context of current geopolitical uncertainties, including, but not limited to, the situation in Iran.

As shown in Figure 1, commercial oil inventories in OECD countries *outside North America* are low.

As shown in Figure 2, spare capacity is low, geopolitical risk is high, and a conflict that would block the Strait of Hormuz would dwarf any disruption in modern history and rattle traders' nerves, contributing to a risk premium (see Figure 3).

In addition to the pressure imposed by rising crude prices, gasoline prices have also been driven higher by an unusually large shutdown of refining capacity. As EIA noted,[5] in September, 2001 two Pennsylvania refineries amounting to 27% of East Coast refining capacity closed. If a third, planned Pennsylvania refinery closure is included, East Coast refinery capacity is set to fall 52% within one year. In addition, the Hovensa refinery in the US Virgin Islands closed, as did refineries in Europe that supply the US with gasoline. This rash of refinery closures is expected to considerably tighten the East Coast gasoline market and sparked buying of gasoline futures starting in January. Going forward, and irrespective of underlying crude oil prices, the East Coast – the nation's largest gasoline market – will need to pay higher prices for long-haul imports, competing for waterborne barrels in South America, where gasoline demand is rising sharply.

Crude oil price volatility is here to stay, and wider pump price swings will unavoidably result

Oil prices are going to gyrate more wildly than in the past as Saudi Arabia and OPEC's ability to prevent price spikes erodes due to reduced spare capacity. The world oil market is leaving the relatively stable OPEC era and entering a new "Swing Era" in which large price swings rather than cartel production changes will balance global oil supply and demand. The Swing Era portends much higher oil price volatility, investment uncertainty in conventional and alternative energy and transportation technologies, and lower consensus estimates of global GDP growth. Ironically, Western governments and investors will miss OPEC, or at least the relative price stability OPEC tried to provide.

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[2] http://www.eia.gov/energyexplained/index.cfm?page=gasoline_factors_affecting_prices
[3] EIA data, through February 27, 2012
[4] *The Availability and Price of Petroleum and Petroleum Products Produced in Countries Other Than Iran,* EIA, February 29 2012
[5] *This Week In Petroleum*, EIA, January 19, 2012

To elaborate further, the changing role of OPEC - with its implications for oil price stability - is the most important, and so far overlooked, feature of global energy markets. It will have enormous consequences for US economic and foreign policy, especially in our bilateral relations with Saudi Arabia, as noted further below. In short, soaring global demand and constrained supply growth is causing OPEC to lose its spare capacity cushion and therefore its ability to stabilize oil prices. While intuitively OPEC losing control may seem like a good thing, it actually means global oil prices, and therefore our pump prices, are going to swing much more wildly in the future, at times high enough to contribute to recessions as they did in 2008.

As a commodity, oil exhibits what economists call a very low price elasticity of demand. In plain English, this means supply and demand are very slow to respond to price shifts. Oil is a must-have commodity with no exact substitutes; when pump prices rise, most consumers have little choice in the near term but to pay more rather than buy less. And on the supply side, it takes years to develop new resources, even when the price incentive to do so rises sharply.

Since the beginning of the modern oil market, producers have tried to mitigate the tendency of oil prices to swing wildly. Standard Oil, the Texas Railroad Commission and the "Seven Sisters" (major western oil companies) succeeded at stabilizing prices by controlling supply, most importantly by holding spare production capacity back from the market and using it to balance swings in supply and demand. The 1967 Arab oil embargo did not lead to a major oil disruption or price spike, partly because the United States had spare capacity in reserve and increased production to make up for lost Arab producer exports. The 1973 Arab oil embargo did lead to an oil price spike, mainly because the year before – in March 1972 to be exact – the United States ran out of spare capacity.

OPEC took over control of the global oil market from the US and the Seven Sisters in the early 1970s. Since the mid-1980s, OPEC's main tool to stabilize prices has been holding and using spare production capacity. If demand jumped unexpectedly or if supplies were suddenly disrupted, OPEC producers with spare capacity, especially Saudi Arabia, would release more oil, reducing the need for prices to swing in order to balance supply and demand.

But the 2004-2008 period marked the first time since 1972 that capacity nearly ran out[6] absent a major conflict in the Persian Gulf. As in 1972, the reason was demand was racing faster than production. But today, no new cartel is waiting in the wings to satisfy global crude appetites. In 2008, market balance was achieved by sharply rising oil prices along with a sharp decline in demand induced by the financial crisis. While many in Washington, Paris, Riyadh, and Beijing publicly blamed financial market participants, energy experts and economists pointed instead to strong demand for a price inelastic commodity running up against a finite supply.

Going forward, OPEC will still be able to influence how and when oil prices bottom. It can and likely will still take oil off the market to keep prices from falling or to raise them, as it did in late 2008 and 2009.

But OPEC's ability – really, Saudi Arabia's ability – to prevent damaging price spikes has eroded. Therefore, a replay of the mid-2000s is more a question of when than if. Recently, non-OPEC supply growth and OPEC spare capacity were revised sharply down, suggesting the tightening trend may be underway, though an economic downturn may still soften up the global oil market and cause oil prices to fall.

In general, global GDP growth remains oil intensive, driven by voracious consumption in fast-growing Asian and Middle Eastern markets. While world GDP grows strongly, non-OPEC supply growth is not expected to rise fast enough to meet incremental oil demand, requiring OPEC producers to increase production. But OPEC is not investing enough in total production capacity to meet demand growth and still maintain the *minimum* 4-5 mb/d spare capacity buffer needed to assure market participants it can respond to disruptions or tighter-than-expected fundamentals by adding supply. Saudi Arabia, the main spare capacity holder, says it will hold only 1.5 to 2.0 mb/d of spare capacity, and most other OPEC countries hold little if any back in spare.

Taken together, voracious demand and constrained supply trends mean the world can enjoy 4% GDP growth or double digit crude oil prices, but probably not both. As OPEC fails to cap rising prices, price increases large enough to ratchet down demand will enforce the iron law that at the end of the day the world cannot consume what it cannot produce.

Lower import dependence is welcome but will not insulate motorists from gyrating gasoline prices

Higher US and hemispheric oil and gas production is great news for our economy and energy markets. If the investment and regulatory climate allows industry to realize the full supply potential, it will mean more jobs, improved

[6] Many market participants believe Saudi spare capacity was completely exhausted in the summer of 2008, despite EIA data indicating less than 1 mb/d was remaining. Generally, private market participants tend to believe official estimates of spare capacity are overstated.

resilience to supply disruptions, and a lower current account deficit. Our companies and workers will have opportunities to take advantage of these same techniques and technology to unlock unconventional oil and gas resources abroad.

But the good news must be viewed in perspective. Even if we were entirely self-sufficient in oil, our pump prices would still move up and down with global crude oil prices. Oil is fungible, widely traded, and priced in a global market. A crude price shock anywhere is transmitted to pump price changes everywhere.

Therefore our gasoline prices are and will remain strongly linked to trends and developments in the global oil market, not our import share. As leading oil expert Daniel Yergin wrote in a recent Washington Post editorial, "[t]here is only one world oil market, so the United States – like other countries – will still be vulnerable to disruptions, and the sheer size of the oil resources in the Persian Gulf will continue to make the region strategically important for the world economy."[7]

A temporary logistical distortion has caused a crude glut in the US Midwest but it has not affected gasoline prices much other than in the Rockies

A glut of crude oil has built up in the US Midwest as a result of rising Canadian and US production and infrastructure bottlenecks that prevent this supply from reaching refineries connected to the global oil market. As a result, the price of WTI crude – which is delivered in Cushing, OK – has fallen well below prices of other benchmark crudes, such as Brent. As noted by the Energy Information Administration[8] and illustrated in the attached graph, lower Midcontinent crude prices have not translated into lower gasoline prices in the Midwest. Gasoline prices have generally tracked global crude prices, represented by Brent, and not WTI. The reason is the Midwest must import gasoline and other products by competing for them with markets on the coast that are exposed to global oil prices. An exception is the Rocky Mountain region ("PADD IV"), which has enjoyed lower gasoline prices than the rest of the country because it is much more sufficient in refining capacity.

The main winners from the temporary logistical distortion in the Midwest crude market are refiners who are fortunate enough to buy crude at low prices for their refineries and charge customers global gasoline prices. The losers from this distortion are domestic and Canadian crude producers.

Financial market participants contribute to the formation of prices but there is no evidence they are distorting or manipulating them

Financial market participants play an active and healthy role in forming oil prices. The active participation of financial investors in oil futures and derivatives markets is legal and desirable, as it enables energy consumers and producers to transfer price risk and protect against price swings. They also help bring information to the market and can smooth excessive price swings. Like all market participants, their activities should be well policed for manipulation and fraud. The CFTC and other regulators police actively against instances of fraud or manipulation in financial markets, and recently imposed position limits under Dodd-Frank are intended to prevent excessive speculation. The Commodity Futures Trading Commission is working carefully to build a solid foundation for appropriate position limits, which requires an enormous amount of data collection. If the CFTC is overly hasty or incautious, it could subject the position limits rule to legal challenge or inadvertently chase financial market activity to other venues.

In order to "distort" or "manipulate" prices, financial market participants would have to hoard physical supply and take advantage of weak or broken convergence between paper and physical markets. In the global oil market, there is no evidence of such hoarding or weak paper-physical convergence. In the past years, many US and international regulators and energy officials have investigated the role of financial market participants and oil prices, and to my knowledge none have concluded that financial market participants were distorting or manipulating oil prices or were the primary reason for recent oil price volatility. Authoritative and unbiased official agencies with expertise and access to information have examined the increased participation by financial investors in oil price formation and concluded recent price behavior has been driven mainly by supply-demand fundamentals.[9]

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[7] Daniel Yergin, "Oil's new world order," *Washington Post*, October 28, 2011.

[8] "Unlike Rocky Mountains motorists, those in the Midwest have not been able to parlay regional refiners' crude cost advantage into relatively lower retail product prices - most likely because the Midwest, for all its recent increases in refinery runs, remains far less self-sufficient than the Rockies in product supply. As Midwest markets continue to pull gasoline from the Gulf Coast, it is the higher cost of bringing in those Gulf Coast barrels, rather than Midwestern production costs, that tends to set Midwest product prices." *This Week In Petroleum*, EIA, January 25, 2012

[9] Medium Term Oil and Gas Markets 2012, International Energy Agency, p. 29. See also "Energy and Financial Markets Overview: Crude Oil Price Formation," EIA, May 5, 2011; Box1.4, IMF World Economic Outlook, September 2011, pp 56-60; Dallas Federal Reserve, October

In the new "Space Mountain" era of gyrating oil prices, there will be greater demand by energy consumers and producers to buy insurance from oil price swings and therefore a bigger need for financial market participants to provide that insurance. As Michael Levi and I wrote last summer:

> Policymakers should help facilitate more hedging by encouraging the development of well-regulated financial markets: the point is to relieve those who are exposed to price risks today—from motorists to airlines and other oil-intensive industries—and transfer those risks to speculators, who are more willing and better able to bear them. The Dodd-Frank financial reform legislation of 2010 took some helpful steps in this direction, such as requiring that most transactions be conducted on regulated exchanges and that the Commodity Futures Trading Commission collect and publish better data on a wider range of transactions.
>
> Officials should take care not go too far, however, and prescribe overly harsh limits on speculative bets in energy futures, and other costly barriers for firms that need to hedge. A blanket crackdown on hedging and speculation would only increase firms and consumers' exposure to volatility, by shrinking financial markets and chasing hedging to less transparent and less regulated venues."[10]

Strategic stocks should not be used to smooth gasoline prices

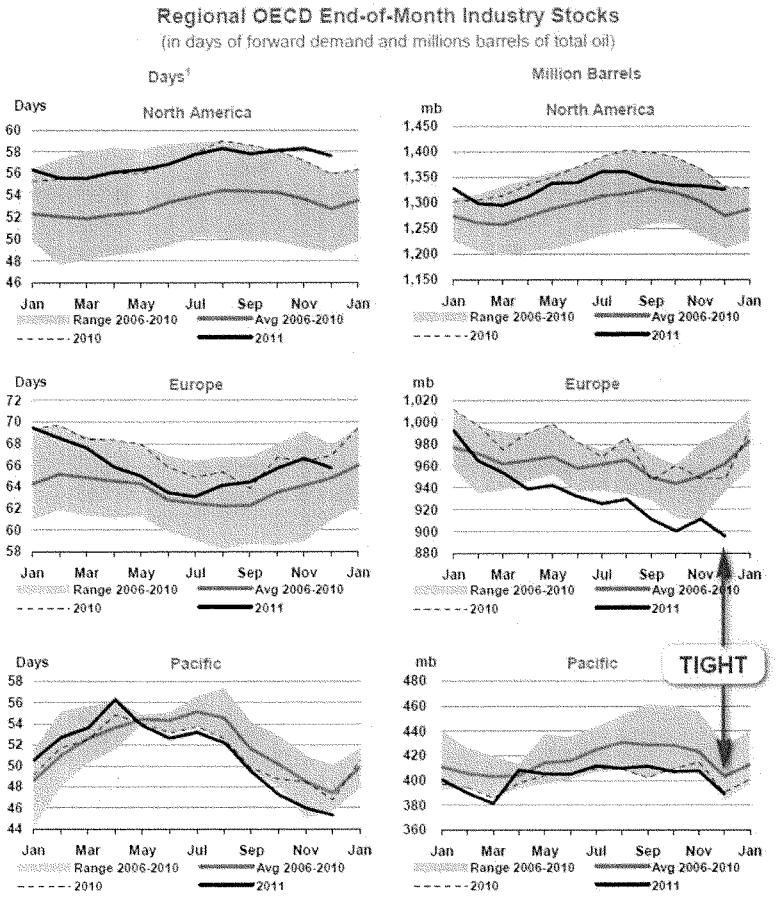
As we realize OPEC can no longer cap oil and therefore gasoline prices, clamor for the United States to use its strategic reserves to moderate prices will rise. Absent a severe supply disruption, this would be deeply unwise. If the US tries to use strategic stocks to keep gasoline prices stable, it is likely to end up with neither strategic stocks nor gasoline price stability. There are several points to consider:

- Strategic stocks are finite and too small to have a lasting impact on oil prices. In a 90 million barrel per day market prone to large, unexpected swings in supply and demand, sporadic SPR withdrawals of 1 to 3 million barrels a day are unlikely to influence global fundamentals and therefore prices other than in the very short term, if at all.
- Officials do not have sufficient information to know when or how much oil to add or subtract from the global market to keep prices stable, and could well run out of supplies before they managed to flatten prices. Good data on global oil market supply and demand is lacking, and the best data are available only with lags measuring calendar quarters and years.
- Even if the US had sufficient information, decisions on when to use the SPR would be influenced by political pressures and factors rather than economic ones.
- Using the SPR would induce private companies to hold lower stocks, and OPEC could offset the impact by cutting production, as seen after President Clinton ordered an SPR stock draw in September 2000.
- Frequent, capricious frittering away of strategic stocks in a futile attempt to influence global oil prices would *increase* market uncertainty and price volatility.

2011, http://dallasfed.org/research/eclett/2011/el1110.html; and "Interim Report on Crude oil, Interagency Task Force on Commodity Markets, CFTC, July 2008."

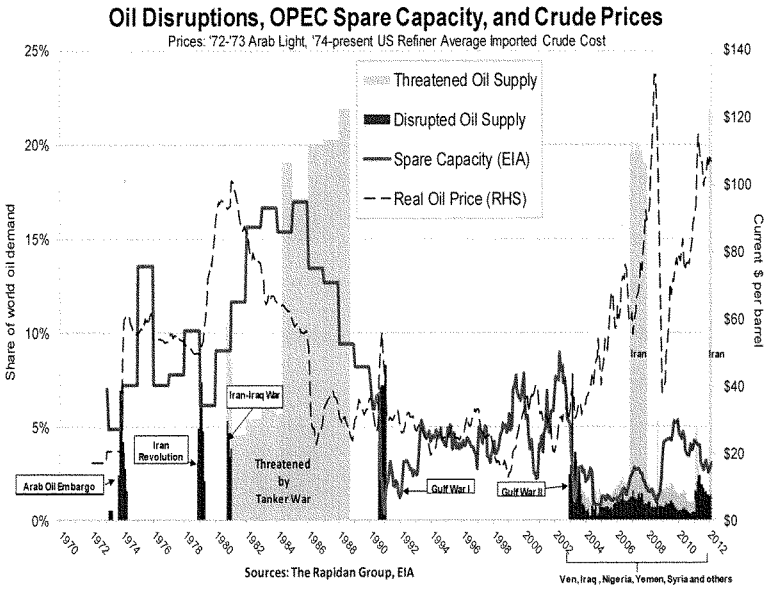
[10] "A Crude Predicament: The Era of Volatile Oil Prices," Robert McNally and Michael Levi, *Foreign Affairs*, July/August 2011

Figure 1



IEA Oil Market Report, February 10, 2012

Figure 2


Oil Disruptions, OPEC Spare Capacity, and Crude Prices
Prices: '72-'73 Arab Light, '74-present US Refiner Average Imported Crude Cost
Threatened Oil Supply
Disrupted Oil Supply
Spare Capacity (EIA)
Real Oil Price (RHS)
Share of world oil demand
Current $ per barrel
25%
20%
15%
10%
5%
0%
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$100
$80
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$20
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Arab Oil Embargo
Iran Revolution
Iran-Iraq War
Threatened by Tanker War
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Sources: The Rapidan Group, EIA
Ven, Iraq , Nigeria, Yemen, Syria and others

Figure 3

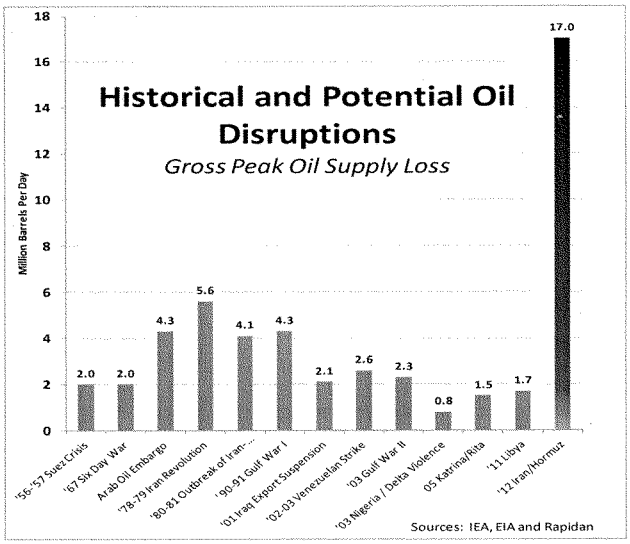
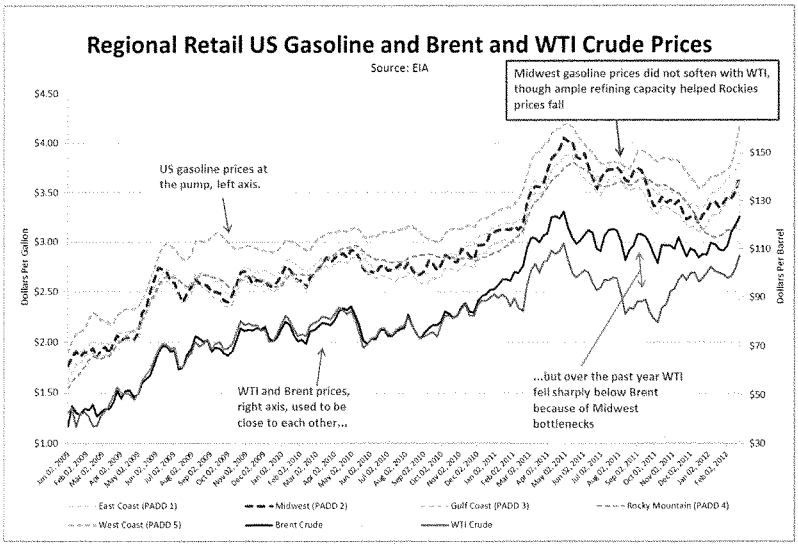


Figure 4



FOREIGN AFFAIRS

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A Crude Predicament

The Era of Volatile Oil Prices

Robert McNally and Michael Levi

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A Crude Predicament

The Era of Volatile Oil Prices

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For most Americans, from the late 1970s until just a few years ago, following the price of gasoline was like riding the Disney World attraction It's a Small World: a shifting but gentle, basically unremarkable experience. But over the past few years, it has felt more like Space Mountain—unpredictable, scary, and gut-wrenchingly uneven. Between January 2007 and July 2008, the price of a barrel of oil rose from $50 to more than $140; by the end of 2008, it had crashed to just over $30; less than a year later, it had breached $80 again. In early 2011, on the back of strong global demand and the political turmoil in the Middle East, oil sold for over $120 a barrel. Today, as prices continue to swing wildly, most Americans are wondering how they got on this ride and how to get off.

Over recent years, Americans have grown accustomed to considerably higher oil prices than those of the 1980s and 1990s. But they have not yet come to terms with sustained swings in global crude oil prices. High prices are easy enough to explain. Voracious demand in emerging economies is colliding with constraints on production. Old oil fields are producing less, and new fields are more expensive

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Robert McNally, President of the Rapidan Group, served as Special Assistant to the President at the U.S. National Economic Council and Senior Director for International Energy at the U.S. National Security Council under President George W. Bush. Michael Levi is David M. Rubenstein Senior Fellow for Energy and the Environment at the Council on Foreign Relations.

to develop. Governments with access to cheaper resources have restricted investment in new supplies, for various reasons. Faced with popular discontent, petrostates in the Middle East and North Africa, for example, are spending their oil revenues on trying to placate their burgeoning populations with subsidized food, gasoline, and other necessities.

The volatility of oil prices requires a different explanation. Textbook economics says that prices rise and fall in order to balance supply and demand. In the oil market, however, supply and demand are extremely slow to respond to price shifts, which means that prices can undergo big swings before a balance is restored. Oil is a must-have commodity with no exact substitutes; when prices rise, most consumers have little choice in the near term but to pay more rather than buy less. It takes years to develop new resources, and it is difficult to turn production on or off on short notice. When new supplies (usually years in the making) threaten to flood the market or a sudden drop in demand (for example, due to a recession) leaves sellers without ready buyers, prices can plunge before producers start shutting the taps. Oil prices naturally tend toward extremes.

Yet these extremes have long been kept in check. From the inception of the modern oil market in 1859 until recently, producers have employed a variety of tools to stabilize prices, including vertical integration and market-share agreements. Since the mid-1980s, spare production capacity has been the only tool available. If demand jumped unexpectedly or if supplies were suddenly disrupted, OPEC producers with spare capacity, especially Saudi Arabia, would release more oil, obviating the need for prices to swing in order to balance supply and demand.

Now, much of OPEC's influence is gone. Saudi Arabia and its partners no longer consistently hold the large volumes of spare capacity they once did. And there are no ready replacements waiting in the wings. The oil market is in for a rocky ride, with major economic and geopolitical consequences: underinvestment in the development of energy, greater economic sensitivity to geopolitical unrest in oil-producing regions and shipping lanes, and a higher risk of recessions. The United States will find it impossible to eliminate price swings in the coming years, and so it will need to learn to live with them as best it can.

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Robert McNally and Michael Levi

GOOD TILL THE LAST DROP

TRADITIONALLY, OIL producers were able to find new oil faster than demand for oil grew. As a result, price busts would wipe out profits and investments—followed by rises in demand and then booms. Producers thus sought to put a floor on prices by holding oil off the market. In addition, in order to limit competition and ensure healthy demand, they also sought to cap prices, adding extra oil to the market in tighter times. In the early 1930s, Washington, other Western governments, and international oil companies took control of supplies—and prices. Blessed with massive low-cost resources, Texas played a pivotal role by holding as much as 25 percent of its production capacity in reserve. (Conventional wisdom has it that about five percent of global supplies provides a robust buffer against surprise developments in the market.) During the June 1967 Arab-Israeli war, for example, the Railroad Commission of Texas, which regulates the Texan oil industry, helped blunt the effects of an Arab oil embargo by drawing on its spare capacity. But in 1972, faced with surging demand in the United States, the chair of the commission was forced to order full production throughout the state. Thus, when the 1973 Arab-Israeli war triggered another Arab embargo, Texas, which was already operating at full tilt, was unable to produce more oil on short notice. Prices soared.

Then, OPEC took the reins, and influence over oil prices shifted to the Middle East. For the next three decades (except briefly during the Gulf War), OPEC held the requisite spare capacity or more. Whenever surprisingly strong demand threatened to outstrip supply and send prices shooting up, OPEC released extra supplies to give the market some breathing room. For example, after demand surged in 2000 on the back of Asia's recovery from the 1997–98 financial crisis and the dot-com boom, OPEC drew on its spare capacity to increase production. In 2003, following a general strike in Venezuela, civil unrest in Nigeria, and the U.S.-led invasion of Iraq, OPEC, led by Saudi Arabia, increased production by 2.5 million barrels per day, about ten percent of its usual output.

Saudi Arabia had been able to maintain substantial spare capacity during the last quarter of the twentieth century because global

demand growth was moderate and supply was growing in most major producers outside OPEC. The Saudi government allowed its competitors to expand their market shares, content to keep some of its supplies in ready reserve and act as the central banker of oil—and thereby make itself an indispensable partner of the United States in the Middle East.

But a decade ago, its grip began to falter. In early 2003, when the invasion of Iraq took about a million barrels of oil off the market, Saudi Arabia had to fill the gap. But then, despite major investments in supplies, it was unable to replenish its spare capacity to prewar levels because of voracious demand from the developing world and a lack of supply growth outside OPEC. It, as well as other producers, had to choose between meeting burgeoning demand and taking oil off the market to hold in spare capacity. It chose the former, hoping to stave off a spike and then a crash in prices. Ultimately, however, its production increases were insufficient.

With producers nearly tapped out amid strong demand, it took a brutal spike in prices in 2008—prices rose by 67 percent within six months—along with a global economic recession, to finally bring demand in line with supply. Demand dropped by three million barrels a day, or about four percent, between the first quarter of 2008 and the first quarter of 2009. This enabled OPEC to cut production and restore some meaningful spare capacity to the system, albeit temporarily. As the global economy recovers, and supply growth starts to become sluggish again, spare capacity will dwindle once more.

A repeat of the boom-bust pattern is now more likely than not. The International Energy Agency, the U.S. Department of Energy, and many experts estimate that Saudi Arabia and its OPEC partners are not investing enough in production capacity today to meet both increasing demand and the five percent threshold for reserves. This is largely because Saudi Arabia, historically the main holder of OPEC's spare capacity, is both less able and less willing to play the part. Saudi officials say they plan to keep as spare capacity only 1.5–2.0 million barrels of oil a day, or less than two percent of global demand.

As they regularly note, holding extra capacity is expensive. For example, the Manifa oil field, Saudi Arabia's next big project to shore up production capacity and prevent its spare capacity from dropping

even further, will cost about $16 billion just to build and will add only 0.9 million barrels per day of capacity. Despite such efforts to expand production, Saudi Arabia remains worried about oversupplying the market and thus depressing prices, and so it is likely to aim low in its planning for spare capacity. It worries that if demand grows more slowly than anticipated—demand growth in Asia is much tougher to predict than it used to be—or other countries' supplies turn out to be larger than expected, it will be saddled with low prices or massive amounts of unused investment.

Just as Saudi Arabia's ability to hold spare capacity is declining, its incentives to do so are waning, too. With U.S.-Saudi ties having frayed over the last decade, Riyadh's motivation to continue contributing to its security partnership with the United States by maintaining spare crude capacity has diminished. In the past, Saudi Arabia held spare capacity partly as a way of disciplining OPEC: spare capacity allowed it to threaten to punish cartel members by flooding the market if they cheated on their quotas. It also allowed Saudi Arabia to align itself with the United States by countering calls for higher oil prices by price hawks such as Iran and Venezuela. But today, Riyadh is less certain about the strength of its alliance with Washington and may thus be less willing to incur the costs and risks involved in contributing to the U.S.-Saudi partnership in these ways.

With insufficient spare capacity left in OPEC, the oil market is in for a rocky ride.

To be sure, Saudi Arabia and OPEC will maintain some influence over oil prices in the future. They can prop them up in the short term by capping production and in the long term by limiting investment in new supplies. But they will not be able to consistently put a lid on prices. U.S. officials have forecast low spare capacity through 2012 (their projections do not extend any further), and the International Energy Agency anticipates that between 2013 and 2016, OPEC's spare capacity will be below the five percent threshold. Some developments could ease the pressure on supplies: a slowdown of economic growth in Asia; improved security in Iraq, leading to increased production there; political change in Iran or Venezuela that allowed international capital and technology to flow into those countries' oil sectors. Yet

any of these changes would take many years to translate into large increases in supplies. The development of alternative technologies for transportation, the faster adoption of fuel-efficient vehicles, and the greater use of natural gas in the transportation sector could also change the picture. But such transitions would also take many years, if not decades.

There are no other producers capable of stepping into Saudi Arabia's shoes. Only Russia and the United States produce volumes comparable to Saudi Arabia's. (According to the International Energy Agency, in 2010, Russia produced about 10.4 million barrels per day; Saudi Arabia, about 8.1 million barrels per day; and the United States, 7.8 million barrels per day. Iran, the world's fourth-largest producer, accounted for only 3.7 million barrels per day.) But Russian oil, which is more expensive than Saudi low-cost oil, is ill suited to serve as spare capacity, and Russia has also shown little interest in cooperating with other producers to help stabilize prices. Nor is there any prospect that the United States will step back into the swing-producer role it played half a century ago, when it held huge low-cost reserves and was not massively dependent on imported oil.

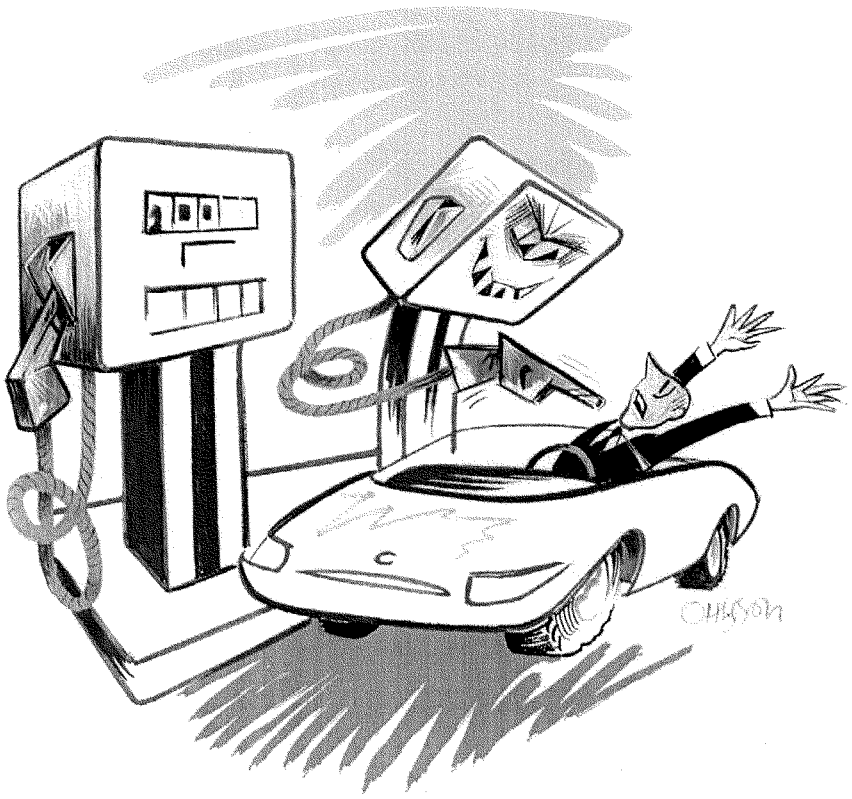
A MORE DANGEROUS WORLD

THE WORLD will be stuck with wild price swings for the foreseeable future. Already, the consequences for economics and geopolitics are stark. Big shifts in oil prices complicate economic decisions. Companies in many sectors avoid investing in new facilities and equipment that may be profitable at low oil prices but are all but useless if prices soar. Individual consumers are buffeted as their disposable incomes drop when their gasoline and home heating bills rise. Basic decisions become more difficult: it is not so easy to choose whether to buy a gas-guzzling SUV or a hybrid Prius if you do not know whether gasoline will cost $3 a gallon or $5 in a few years. Airlines, petrochemical producers, and other oil-intensive industries also face much greater uncertainty about costs and profits. Companies that make investments on the basis of low oil prices and are later forced to pay more wind up cutting back on spending elsewhere, depressing the entire economy.

Greater oil price volatility will also bedevil macroeconomic policy officials and central bankers. Policymakers may have to compensate for depressed demand by lowering interest rates or pursuing fiscal stimulus. On the other hand, rapidly rising oil prices could fuel inflation, prompting monetary policy officials to raise interest rates, which could further hamper economic growth. The precise causal links between oil prices and the well-being of national economies are murky and much debated, but as the economist James Hamilton has noted, all but one of the 11 recessions the United States has experienced since World War II were associated with a rapid increase in the price of oil. U.S. policymakers will inevitably worry that greater swings in oil prices will translate into greater macroeconomic volatility and respond accordingly.

Developing economies, many of which are particularly dependent on oil, will also be hurt. And their attempts to insulate themselves from price volatility will have global reverberations. These states have historically subsidized gasoline and diesel prices at home in order to shield their citizens and domestic companies from international volatility. But these subsidies have had pernicious effects on prices worldwide. With prices kept artificially low in the parts of the world with subsidies, the burden of adjusting to the mismatch between global demand and global supply has fallen on the smaller subset of consuming countries that do not have subsidies. There have been some tentative moves away from gasoline and diesel subsidies in the last few years, most notably in China and India, because these incentives have placed unsustainable strains on government treasuries. The G-20 has also launched an effort requiring its members to develop plans to phase out inefficient subsidies in the medium term. But further reforms may stall in the face of renewed price swings and popular demand for protection; in the worst cases, recent improvements might even be reversed.

Low levels of spare capacity will also complicate U.S. foreign policy. The smaller the spare capacity, the bigger the threat of a price spike from any political disruption. These higher stakes will put pressure on the United States—still the indispensable nation when it comes to providing global stability—to intervene in conflicts that threaten even relatively small volumes of oil, whether in West Africa, the Middle



East, or Central Asia. Similarly, as U.S. policymakers ratchet up pressure on Tehran over Iran's nuclear program, they are considering crimping Iran's crude oil exports. But with OPEC's spare capacity now barely larger than Iran's exports, that strategy could send oil prices spiraling upward—even if Iran did not threaten the Strait of Hormuz and even if the United States and its allies released oil from their strategic reserves.

LEARNING TO SWING

GREAT OIL price swings are here to stay, and there will be little refuge from their pernicious consequences. Nonetheless, there is much that the U.S. government can do to avoid the worst. No one

measure can transform the situation, but by pressing for change on many fronts at once, the United States can limit its vulnerability to volatile prices.

A sensible and prudent approach would start by ensuring that the market has as much information about supply and demand as possible. More reliable data would dampen short-term volatility by reducing uncertainty and facilitate timely investments in production capacity, limiting the amplitude of price extremes over the long term. Industrialized countries should start by getting their own houses in order, improving the quality, timeliness, and frequency of their oil market data. (The United States and Japan are the only major countries whose governments collect and publish reasonably timely, accurate, and broad data on their own oil supplies and demand.) They should then push for more comprehensive and timely data on spare capacity and production trends from the OPEC states, which have historically been tightlipped, by arguing that a change in approach would benefit OPEC itself. The oil market is increasingly distrustful of the numbers published by OPEC members, and if that trend continues, these states will lose more of whatever leverage over prices they still have. More information sharing may be their only chance of preserving their influence.

Because of rapidly increasing consumption in Asia, the U.S. government should also seek to draw Asian governments into international efforts to share data on consumption, stockpiles, and production, by allowing these states to join the International Energy Agency (which provides such services for members of the Organization for Economic Cooperation and Development) or another institution. The secretive Chinese government has been particularly reluctant to participate in such arrangements so far. But as its oil consumption balloons, China increasingly stands to gain from tamping down volatility, too.

Yet price swings will persist. In order to help consumers and companies deal with unpredictable oil prices, the United States should encourage more hedging through the financial markets. This idea may trouble those who blame speculators for price swings, but careful studies by the U.S. Energy Information Administration and the U.S. Commodity Futures Trading Commission have found

that medium-term and long-term price shifts are primarily a function of changes in global supply and demand. Policymakers should help facilitate more hedging by encouraging the development of well-regulated financial markets: the point is to relieve those who are exposed to price risks today—from motorists to airlines and other oil-intensive industries—and transfer those risks to speculators, who are more willing and better able to bear them. The Dodd-Frank financial reform legislation of 2010 took some helpful steps in this direction, such as requiring that most transactions be conducted on regulated exchanges and that the Commodity Futures Trading Commission collect and publish better data on a wider range of transactions.

Demand-side policies, such as taxing gasoline and diesel, must be at the core of any serious strategy for coping with volatile oil prices.

U.S. officials, both in Congress and in the executive branch, should take care not go too far, however, and prescribe overly harsh limits on speculative bets on energy futures or set other costly barriers for firms that need to hedge. A blanket crackdown on speculation would only increase the exposure of firms and consumers to volatility by shrinking financial markets and chasing hedging to less transparent and less regulated venues.

As it becomes clearer that OPEC has lost control, people will clamor for the United States to use its strategic reserves to moderate prices. But it would be unwise for Washington to use these supplies for purposes other than responding to substantial supply disruptions, such as those caused by turmoil in a major oil-producing country or a critical shipping lane. Officials are unlikely to know when and how much oil to add to or subtract from the global market in order to keep prices stable, and they could exhaust the country's strategic reserves before they managed to flatten prices. (Unlike a central bank, which can always print more money, the U.S. Strategic Petroleum Reserve can quickly bring online only a finite amount of extra oil.) The use of strategic reserves would also introduce new uncertainty—as well as greater economic vulnerability—into the market by giving both companies and consumers less reason to limit their own exposure and by deterring

the buildup of private stocks. At the same time, Washington should reinvigorate efforts to draw the new major oil-consuming states, such as China, into coordinating their policies on strategic reserves. Now that China is finally building strategic reserves, it should share the burden of responding to disruptions with the United States and others. A coordinated policy would make the world better able to respond to supply disruptions and thus limit unnecessary price swings.

The United States will also need to redouble its efforts to discourage subsidies to consumers. The G-20 initiative to reduce subsidies has been a third-tier priority for U.S. economic policymakers, partly because they see it as an element of climate policy. But curbing subsidies would help blunt volatility, and thus improve economic performance; therefore, even policymakers who care more about economic growth than greenhouse-gas abatement should embrace it. Progress will be difficult, however, because subsidies are fundamentally rooted in the domestic politics of the countries that pursue them and fall outside the United States' leverage.

Policies that aim to increase global oil supplies, and thus reintroduce a modicum of spare capacity to the market, will be equally challenging. Efforts to promote security in Iraq, address Tehran's nuclear program, and encourage positive political evolution in Iran and Venezuela could not only remove regional security threats but also significantly increase global oil supplies. (The logic behind each of these efforts is not primarily determined by energy policy, but their potential payoffs in terms of energy policy should inform U.S. strategy.) The U.S. government should also encourage countries with large, low-cost oil reserves to invest in more production capacity. (Although Saudi Arabia's recent decision to speed up investment in the Manifa offshore project is encouraging, it will not fundamentally change the situation.) But persuading producers to spend more on new supplies will be an uphill battle both because increased volatility has made them more cautious investors and because they may face limits on how much their production can expand. Although all these initiatives are tall orders, given the potential benefits, they are well worth a try.

The United States has much more leverage at home. With the risk of price spikes high, it should help insulate its economy by encouraging more domestic oil production. Smart U.S. policy could

help promote domestic production: regulations that are cost-effective, clear, and consistent, and that ensure environmental protection, are essential. Similarly enlightened policy on natural gas could also pay dividends in the long term, especially if it helped transform the transportation sector.

Ultimately, however, demand-side policies must be at the core of any serious strategy for coping with volatile oil prices. The goal should be to help consumers protect themselves from fluctuating oil prices while accelerating investment in fuels and technologies that can scale up and eventually displace oil. The transition away from oil in the transportation sector will take decades, but it is inevitable and it can be hastened. The U.S. government should reallocate funds currently spent on mature energy technologies toward research and development for alternative technologies at the early stages of development. In the context of serious fiscal reform, it should also gradually raise taxes on gasoline and diesel (while compensating for those hikes by lowering payroll taxes). This shift would not only discourage consumption (while rewarding work); it would also shield consumers from price volatility: if taxes accounted for a larger fraction of the pump price of gasoline and diesel, swings in the underlying price of crude would be less consequential. Such taxes have been politically toxic in the past, but they may be more palatable than many of the other options that would be considered in any serious budget debate.

Wild fluctuations in global oil prices are here to stay. The economic and national security implications are stark, and the United States has little choice but to adjust and absorb some of the blows. Policymakers can neither banish big oil price swings nor reasonably hope to wean the United States off oil in the foreseeable future. But the right policies can improve the country's economic resilience and minimize the geopolitical complications of this new and challenging time.

Mr. WHITFIELD. Thank you, Mr. McNally.
Mr. Gerard, you are recognized for 5 minutes.

STATEMENT OF JACK N. GERARD

Mr. GERARD. Thank you, Chairman Whitfield, Ranking Member Rush, and members of the subcommittee. Thank you for inviting me here today to speak to you about the rising cost of fuel.

Americans are understandably frustrated by rising fuel costs, which is the direct result of weak energy policy. America is energy-rich, yet too many talk like we are powerless to do anything but watch global events drive energy costs higher and that there are no solutions.

Members of the committee, that is just not so. With sound policy and bold leadership, we can put this country's vast resources to work to literally change the energy equation.

Gasoline prices are climbing primarily because of the cost of crude oil, which accounts for 76 percent of the price at the pump. The market forces driving crude higher are challenging, but America doesn't have to be held captive to them. We have choices. By increasing access to North American energy, we will help put downward pressure on prices. Supply matters. That is not just API saying so, it is others who have called on the Saudis to produce more, others who have called on other sources, such as the Brazilians, and yet others who recognize supply matters by calling for release from the Strategic Petroleum Reserve. This is not a long-term energy strategy. Government estimates say we will still get more than 55 percent of our energy from oil and natural gas over the next 2 decades, 57 percent of which currently comes from outside the United States. The question is whether we produce that energy here or rely on less stable sources in the future.

With actions today, over the next 2 decades we could add the oil and natural gas equivalent of 10 million barrels a day. The markets would see that America plans to be an energy leader, not a follower, and American consumers would see that help is on the way.

But current policies block this vision. The call for an "all of the above" energy approach sounds good, but we are seeing actions that hinder oil and natural gas development. The administration says one thing, does another, and sends mixed signals to the marketplace. The administration says it is for more oil and gas, but rejects the Keystone XL pipeline, which would bring 800,000 barrels of oil per day. It says it is for boosting domestic production, but new leasing and the number of new wells on Federal lands are both down. Its latest offshore plan keeps 87 percent of these areas off limits, and the Gulf of Mexico production is forecast to be down nearly 21 percent in 2010. The administration says it is for natural gas, but 10 Federal agencies are now considering new regulations that could needlessly restrict our ability to produce here on own shore. It calls for all of the above, but then threatens companies that could lead on energy with an $85 billion discriminatory tax increase.

Mr. Chairman, this is sending the wrong message and must change. Soaring production on State and private lands should be our model. Shale plains in North Dakota, Pennsylvania, and Texas

are game changers, creating jobs, helping consumers, and producing record levels of oil and natural gas. We need that model nationally. Bold action that says we are serious about energy, action that will actually increase supply.

With the right policies and with strong resolute leadership, we can secure our energy future instead of surrendering to outside forces. The President has an opportunity right now to signal the markets and help put downward pressure on fuel prices by showing we are serious about developing our own vast resources. Our industry will help re-urge the President to act now.

Thank you very much, and I look forward to answering your questions.

[The prepared statement of Mr. Gerard follows:]

Statement of:
Jack N. Gerard
President and CEO, American Petroleum Institute
Before the
United States House of Representatives
Committee on Energy and Commerce
Subcommittee on Energy and Power
March 7, 2012

Chairman Whitfield, Ranking Member Rush, members of the subcommittee: Thank you for this opportunity to speak with you today about an energy issue that concerns all Americans – the rising cost of fuel.

The American Petroleum Institute represents every aspect of America's oil and natural gas industry. This industry supports 7.7 percent of our economy, 9.2 million jobs, and the millions of Americans who hold ownership stakes through pension funds, retirement accounts and investments.

Americans are understandably frustrated by rising fuel prices, the result of a weak energy policy. America is an energy-rich nation, one of the world's richest, yet too many talk like we're powerless to do anything but watch global events drive energy costs higher, and that there are no solutions.

Members of the committee, that's just not so. With sound policy and bold leadership, we can put this country's vast resources to work to change the current energy equation.

Gasoline prices are climbing primarily because the cost of crude oil -- which accounts for 76 percent of the price at the pump -- also has been rising, pushed higher by global demand and Middle East tensions. These market forces are challenging, but America doesn't have to be held captive by them.

We have choices. By increasing access to North American energy, we will help put downward pressure on fuel prices.

Supply matters. That's not just API saying so. It's others asking the Saudis to produce more, it's others seeking new suppliers – like Brazil – it's talk of another release from the Strategic Petroleum Reserve.

But none of these alone leads to long-term U.S. energy security. Increasing supply will. Government estimates say we will still get nearly 60 percent of our energy from oil and natural gas over the next few decades. The question is whether we produce that energy here or rely on less-stable sources.

A strategy that confidently deploys resources here at home will send a clear message to global markets that the United States is serious about affecting supply. To the American people it will say help's on the way.

We can send that message right away by approving the Keystone XL pipeline, which would bring 800,000 barrels of oil per day from Canada. We could expand access to our own supplies – offshore and onshore – by allowing new exploration and development on federal lands that currently are off limits.

Over the next two decades we could add the equivalent of 10 million barrels of oil per day to supply our energy needs. Markets built on expectations would see that America plans to be an energy leader, not a follower.

But current policies block this vision. API agrees with the call for an all-of-the-above energy approach, but we're seeing actions that hinder oil and natural gas at nearly every turn.

The administration is saying one thing, doing another and sending mixed signals to the markets.

The administration says it is for more oil and gas, but rejects the Keystone XL pipeline. It says it is boosting domestic production onshore, but new leasing on federal lands is down 44 percent, and the number of new wells drilled is down 39 percent. It says it is opening offshore areas but the latest plan keeps 87 percent of these areas off limits. It says oil and gas activity in the Gulf of Mexico is back to normal, but the latest forecast says production this year will be down nearly 21 percent from 2010. It says it is for natural gas, but 10 federal agencies are looking at new regulations that could needlessly restrict it. It calls for "all-of-the-above" then threatens the companies that could lead an energy renaissance with $85 billion in discriminatory tax increases.

Mr. Chairman, this is sending the wrong message to the global markets. This needs to change.

The effect of greater access is no mystery. Look at what's happening on state and private lands. Shale plays in North Dakota, Pennsylvania and Texas are game-changers – creating jobs, helping consumers, generating revenue to government and producing record levels of oil and natural gas.

We need that model nationally. We need bold action that says we're serious about energy -- action that will increase supply and benefit all Americans.

With the right policies and strong leadership, we can secure our energy future instead of surrendering it to outside forces.

The president has an opportunity right now to send a signal to the markets that will help put downward pressure on fuel prices. He can show the American people that we're serious about developing our own vast resources. Our industry stands ready to help, and we urge the president to act now.

Thank you, and I look forward to your questions.

Mr. WHITFIELD. Thank you, Mr. Gerard.

Mr. Drevna, you are recognized for 5 minutes for an opening statement.

STATEMENT OF CHARLES DREVNA

Mr. DREVNA. Chairman Whitfield, Ranking Member Rush, and Chairman Upton, Ranking Member Waxman, thank you for giving me the opportunity to testify at a very critical hearing here today. I am Charlie Drevna, and I serve as President of the AFPM, the American Fuel and Petrochemical Manufacturers.

We are a trade association that was just recently known as NPRA, the National Petrochemical Refiners Association, until early this year, who represent the high tech American manufacturers who use oil and natural gas to make almost all the fuels, heating oil and petrochemicals used in our Nation today.

As has been stated previously and is absolutely 100 percent accurate, current gasoline prices are primarily driven by high global crude oil prices. The cost of crude accounts for 76 cents of each dollar that consumers pay for gasoline. That is followed by an average of taxes at 12 cents. Next comes distribution and marketing at 6 cents. That leaves refining just 6 cents on every dollar to pay wages, run the refinery in a safe and efficient manner, and produce the fuels that Americans need and deserve. So refiners don't set the price of oil any more than automakers set the price of steel or bakers set the price of wheat. Oil is an international commodity that trades in a free market.

Now historically, the best mechanism to address high crude prices has been to increase global oil supply. When we have done this as a Nation, we have sent that message that the U.S. is serious about meeting our energy and national security needs. American companies could increase the supply of crude oil in two ways. First, the Federal Government would allow increased production of oil in the United States and off our shores. As Mr. Gerard so stated, we are not an energy-poor Nation. We are an energy-rich Nation who lack the political will to develop our own natural resources and to provide consumers with the products they need at a reasonable cost.

Second, President Obama should approve the construction of the Keystone XL pipeline to bring Canadian oil refineries to the U.S. Gulf Coast.

I recently saw a clip on TV, a member of Congress talking about the SPR, and that equated it to Kryptonite in that the SPR was like Kryptonite to the cost of oil. Well, I am not so sure about that, but I am sure that we do have a strategic reserve. Unfortunately, it is locked up. It is locked up off the shores of the Atlantic, it is locked up off the Eastern Gulf, up through the Pacific and all the way through Alaska. It is locked up on Federal lands. It has been locked up for over 30 years, and the critics will say well, it is going to take a lot of time to develop. It is going to take 4 years, it is going to take 4 more years. Well, if we had that same mentality, we wouldn't have the Transcontinental Railroad, we wouldn't have the Hoover Dam, we wouldn't have the Golden Gate Bridge or any other structure that was so needed in this Nation.

So developing our own resources as well as our own natural gas resources is going to produce jobs for American workers and revenues for the government at all levels.

Today, our high crude prices and logistical constraints on a movement of oil and fuel around the country are creating challenges for both refiners and American consumers. In addition, fuel manufacturers are hit with a regulatory blizzard that threatens refinery operations in our Nation. These include Tier 3 regulations to reduce sulfur in gasoline, greenhouse gas regulations, lengthy permit regulations, and finally requirements under the Renewable Fuel Standards involving biofuels. Proposed new Federal regulations threaten to raise the energy costs further for every American consumer, with little or no environmental benefit. These regulations would also threaten American jobs and weaken—further weaken our economic and national security.

One bright spot on the horizon is our export of refined petroleum products, primarily diesel fuel. Exports don't raise gasoline prices; rather, exports bring billions of dollars to America, preserve and create jobs, and strengthen our own economy and reduce our trade deficit. Producing more oil and natural gas right here in America, getting more from Canada and reducing harmful overregulation can't take place overnight, but they would give us our best shot at creating a secure and stable energy supply to serve the American people. Doing these things would also create a manufacturing renaissance, and more American jobs.

Thank you again.

[The prepared statement of Mr. Drevna follows:]

Summary of the testimony by the American Fuel & Petrochemical Manufacturers before the House Energy and Commerce Committee, Subcommittee on Energy and Power – March 7, 2012

1) The current prices consumers are paying at the pump are primarily driven by high global crude oil prices. The cost of crude oil accounts for 76 cents for each dollar consumers pay for gasoline, followed by taxes at 12 cents, distribution and marketing costs at 6 cents, and refining costs at 6 cents.

2) Refiners don't set the price of oil any more than automakers set the price of steel, bakers set the price of wheat or restaurants set the price of cattle. Oil is an international commodity that trades in the free market and its price is not controlled by its purchasers.

3) Historically, the best mechanism available to address high crude oil prices has been to take actions to increase the global crude oil supply. When America has taken such actions in the past, it has sent a message to the market that our country is serious about meeting our energy and national security needs.

4) American companies could increase the supply of crude oil if the federal government allows increased production of oil and natural gas in the United States and off our shores and if President Obama approved construction of the Keystone XL pipeline to bring Canadian oil to refineries on the U.S. Gulf Coast.

5) AFPM supports sound and sensible environmental and other regulations. Our members are strongly committed to clean air and water, have an outstanding record of compliance with Environmental Protection Agency and other regulations, and have invested hundreds of billions of dollars to dramatically reduce emissions as measured by EPA.

6) However, manufacturers of fuels are also being hit with a regulatory blizzard that poses a significant threat to both refinery operations and our nation. This includes Tier 3 regulations to reduce sulfur in gasoline, greenhouse gas regulations, lengthy permitting delays, requirements under the Renewable Fuel Standard involving ethanol and other biofuels, and logistical problems involved with transporting fuels.

7) Proposed new regulations and unnecessary tightening of existing standards threaten to raise energy costs for every American consumer, with little or no environmental benefit. This would strengthen foreign competitors eager to replace American manufacturers and workers, weaken the U.S. economy, make America more reliant on nations in unstable parts of the world for vital fuels and petrochemicals, and endanger our national security.

WRITTEN STATEMENT OF

AMERICAN FUEL & PETROCHEMICAL MANUFACTURERS

AS SUBMITTED TO THE

SUBCOMMITTEE ON ENERGY AND POWER

Committee on Energy and Commerce
United States House of Representatives

on

"The American Energy Initiative"

March 7, 2012

I. Introduction

Chairman Whitfield, Ranking Member Rush and Members of the Subcommittee, thank you for giving me the opportunity to testify at today's hearing on rising gasoline prices. I'm Charlie Drevna and I serve as president of AFPM, the American Fuel & Petrochemical Manufacturers.

AFPM is a 110-year old trade association that was known as the National Petrochemical & Refiners Association until early this year. Our association represents high-tech American manufacturers that use oil and natural gas liquids as raw materials to make virtually the entire U.S. supply of gasoline, diesel, jet fuel, other fuels and home heating oil, as well as the petrochemicals used as building blocks for thousands of vital products in daily life. Most of our members do not have any crude oil and natural gas production operations. But while we do not specifically represent the units of companies that explore and develop oil and natural gas reserves, several of these companies are members of AFPM and we share their goal of a steady, secure supply of oil and natural gas as a vital component of our nation's economy.

AFPM members make modern life possible and keep America moving and growing as we meet the needs of our nation and local communities, strengthen economic and national security, and support 2 million American jobs. The entire oil and natural gas sector – including the producers of oil and natural gas – supports more than 9 million American jobs and pays more than $31 billion a year in taxes to the U.S. government, plus additional funds to state and local governments.

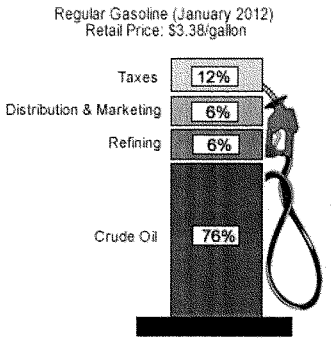
The refined petroleum product prices that we are currently experiencing are hurting American families and businesses struggling to rebound from a prolonged recession. There are many factors behind today's prices, ranging from the high cost of crude oil, to logistical challenges, to regulatory burdens and challenges that compound these factors. While government

policy can do little to address some of these factors, it can do much to address others. More importantly, public officials can work to ensure an overly burdensome regulatory environment does not create a situation that could raise consumer fuel costs even further and disadvantage domestic fuel manufacturers in relation to foreign competitors.

II. Factors Determining Prices at the Pump

The current prices consumers are paying at the pump are primarily driven by high global crude oil prices. As the chart below – taken from the U.S. Energy Information Administration website – shows, only 6 cents of every dollar that Americans pay for gasoline goes to the refining industry that AFPM represents. The cost of crude oil accounts for 76 cents, followed by taxes at 12 cents, and distribution and marketing also at 6 cents.

What we pay for in a gallon of:



Refiners, as well as petrochemical manufacturers, are the first customers of a barrel of oil and are the first to be impacted when oil prices rise. The 6 cents we collect on every dollar spent on gasoline has to pay all our manufacturing costs – including wages and benefits, operations and taxes – and then hopefully provide a profit to keep refineries in business.

Refiners don't set the price of oil any more than automakers set the price of steel, bakers set the price of wheat or restaurants set the price of cattle. Oil is an international commodity that trades in the free market and its price is not controlled by its purchasers.

There are several factors contributing to today's high crude oil prices, including:

- Concerns about the future of Iranian oil production and continued geopolitical uncertainty about how the world will respond to Iran's nuclear ambitions. Iran has even threatened to close the Strait of Hormuz, which carried 35 percent of all seaborne-traded oil in 2011.
- Increased oil demand in China, India and other developing nations, where more and more people are buying cars and rapid industrialization is taking place. Although the economic recovery in the United States is slow to moderate, the developing nations of the world are experiencing more robust growth. This growth is accompanied by an increasing demand for energy, causing petroleum and petroleum products to be in high demand.
- U.S. monetary policy and the decline in value of the U.S. dollar relative to other currencies. Oil is traded on the global market in American dollars, so as the value of the dollar falls, the price of a barrel of crude oil rises accordingly.

Historically, the best mechanism available to address high crude oil prices has been to take actions to increase the global crude oil supply. When America has taken such actions in the past, it has sent a message to the market that our country is serious about meeting our energy and national security needs.

Approval of the Keystone XL pipeline would bring an additional 700,000 barrels per day of Canadian crude oil to Gulf Coast refiners, plus additional oil being produced in Montana and North Dakota. A Department of Energy analysis last year indicated this new supply would act to

lower consumer gasoline costs. Analysis from the consulting firm IHS CERA also indicated Keystone XL approval would put downward pressure on global crude oil prices – the most significant component of consumer gasoline prices.

There are several other steps government could take to free up abundant U.S. and North American supplies of crude oil. My colleagues from the American Petroleum Institute can elaborate more on these measures. In a world where foreign, state-owned oil companies control 80 percent of world crude oil reserves, I would encourage Congress to take steps to make more North American resources accessible to serve the American people and strengthen America's economic and national security.

III. Consumer and Security Impacts of Refining Sector Challenges

High crude oil costs, the recession and foreign competition have created significant challenges for an already competitive refining industry. Coupled with government policies aimed at significantly reducing demand and logistical constraints, these factors have unfortunately led to the closure of several East Coast refineries. New, more affordable sources of crude oil from North Dakota and Montana have only *somewhat* mitigated these factors for mid-continent refiners and consumers. Logistical constraints have still created supply issues impacting consumers in this region.

In just the past few months, three refineries have closed representing more than 713,000 barrels per day (b/d) of domestic refining capacity. In addition, Sunoco announced that it will have to close its 335,000 b/d Philadelphia refinery if it cannot be sold by July. In an Open Letter to the Community published as a newspaper advertisement, Sunoco President and Chief Executive Officer Brian P. MacDonald wrote: "Despite the best efforts of Sunoco's refinery

employees, our Northeast refinery business has lost nearly $1 billion in the past three years." The primary factors contributing to Northeast refining closures include:

- **Crude Costs:** Northeast refineries were built to use high-cost light sweet crude oil as their feedstock to manufacture fuels and other refined products. They cannot use lower-cost sour crude, making them uncompetitive with refineries using the more affordable crude. Factors impacting global crude cost were previously discussed.
- **Decreased Demand:** Fuel demand is down in the United States. U.S. gasoline demand peaked at 9.29 million barrels per day in 2007 and is projected to decline 16 percent in the next few years. This decline in demand has created 2.4 million barrels per day of excess capacity in American refineries. Such demand drops are attributable to the recession, higher Corporate Average Fuel Economy (CAFE) Standards and the Renewable Fuel Standard (RFS). The RFS alone has displaced 10 percent of Northeast gasoline supply and nearly 10 percent of the U.S. gasoline supply. Increasing CAFE standards will likely generate an additional 13 percent reduction in demand nationwide, or an amount equivalent to 18 refineries.

In a recent report, the U.S. Energy Information Administration (EIA) notes that these refinery closures will leave the Northeast and other parts of the East Coast dependent on refined product imports from outside of the region. Some of this lost supply could be made up through recent capacity expansions at refineries in other regions, since there actually is more than ample supply of finished petroleum products in the U.S. However, EIA notes significant logistical challenges pose sizeable hurdles to getting finished petroleum products to the Northeast. Such a reality could create supply disruptions leading to even higher consumer fuel costs. In addition,

the report notes that lost gasoline supply in the region will likely be made up through imports from Europe and Asia, "notably India."

Gasoline supply in the midcontinent faces a different set of factors. As previously mentioned, new oil discoveries on private lands in Bakken region spanning North Dakota and Montana have provided midcontinent fuel manufacturers with a more affordable (but still expensive) source of crude oil. Lack of port access or infrastructure throughout the region can also *somewhat* mitigate the threat of foreign competition.

Compared to the rest of the nation, consumers in the midcontinent area have actually benefitted from this abundant crude supply, experiencing gasoline prices much lower than the national average in many states (see Attachment B). However, these costs are still high and the region is also not without its challenges. The explosion in crude oil development has actually created a bottleneck in the region's main crude oil distribution point of Cushing, Oklahoma. This bottleneck has made the actual crude oil slightly less expensive for refiners, but the bottleneck has created a lack of pipeline capacity needed to get the oil out of the distribution center. Given these circumstances, crude oil has had to be sent out of Cushing via rail cars at a cost significantly higher than pipeline shipments. Such costs, as well as time lags in crude shipments, have contributed to area prices being higher than the historical average.

These market, policy and infrastructure factors impacting the American fuel supply have created a high-cost environment that hampers our nation's economic recovery. Unfortunately, government overregulation is making matters even worse. Proposed new regulations and unnecessary tightening of existing standards threaten to raise energy costs for every American consumer, with little or no environmental benefit. They would also strengthen foreign competitors eager to replace American manufacturers and replace American workers, weaken the

U.S. economy, make America more reliant on nations in unstable parts of the world for vital fuels and petrochemicals, and endanger our national security.

IV. Petroleum Product Exports

One bright spot on the horizon is exports. For the first time since 1949, in 2011 the United States exported more refined petroleum products than we imported. Some pundits and others who don't understand the benefits of exports to the U.S. economy have wrongly stated that we are exporting fuels to force up the price of gasoline. This is absolutely false.

America is still a large net importer of the crude oil needed to make finished petroleum products. We import about 60 percent of the oil we consume. In addition, we're not a net exporter of gasoline – we import more gasoline and gasoline blendstocks than we export. Our big net export is diesel, which is manufactured along with gasoline when oil is refined. Because most Americans drive cars powered by gasoline, we have an oversupply of diesel in our country. It makes sense, therefore, to sell our excess diesel supply to Europe, where most cars run on diesel and to other nations whose economies are growing.

American refineries are the most efficient, highly complex, and competitive in the world. They are positioned to take advantage of this exporting opportunity and to continue to provide high-paying jobs to American workers and economic benefits to our entire nation.

If artificial and counterproductive restrictions were to be placed on these exports, American refineries would be forced to produce less gasoline for American consumers, because the physical properties of crude oil require us to manufacture, on average, one gallon of diesel for every two gallons of gasoline that we produce. It would be absurd and make no economic or business sense to produce products that cannot be sold.

Exports don't raise gasoline prices. Rather, exports bring billions of dollars to America, preserve and create jobs, strengthen our economy and reduce our trade deficit. In fact, in allowing domestic refiners to run at higher utilization rates, exports are likely keeping consumer costs from rising further. If all American manufacturers and agricultural interests were prohibited from exporting their products, they would produce less – and that could actually *raise* consumer prices.

"More exports mean more jobs," President Obama said in his weekly address at a Boeing Plant in the state of Washington in February. "We know what we need to do. We need to strengthen American manufacturing. We need to invest in American-made energy and new skills for American workers." This is exactly what fuel manufacturers are doing.

Some have called for placing a tax on refined product exports. But raising the costs of a product is no way to lower the price. Further, the U.S. Supreme Court has ruled that imposing taxes on exports is unconstitutional. The Constitution outlaws export taxes because the founders knew that exports are a vital component of our nation's economy.

America exports $2.2 trillion worth of products every year. If banning fuel exports represents sound fiscal and economic policy, it would logically follow that America should ban all exports. But no one would suggest that, because it would destroy millions of American jobs and cause tremendous damage to our economy. Banning beef exports wouldn't lower the price of a hamburger, banning auto exports wouldn't lower the price of a car and banning fuel exports won't make gasoline cheaper.

V. Impacts of Regulation on Consumer Fuel Costs and American Competitiveness

AFPM supports sound and sensible environmental and other regulations. Our members are strongly committed to clean air and water, have an outstanding record of compliance with

Environmental Protection Agency and other regulations, and have invested hundreds of billions of dollars to dramatically reduce emissions as measured by EPA.

As a result of these emissions reductions by our members and by other industries, America's air today is cleaner than it has been in generations. Refiners have cut sulfur levels in gasoline by 90 percent just since 2004. We have also reduced sulfur in diesel fuel by more than 90 percent since 2005 and reduced benzene in conventional gasoline by 45 percent since 2010.

EPA data shows that total emissions of the six principal air pollutants in the United States have dropped by 57 percent since 1980 and ozone levels have decreased by 30 percent. These reductions occurred even as industrial output and the number of vehicles on the road have increased. EPA data indicates there will be continued reductions in the years ahead under regulations already in place.

Despite the great progress we have made in environmental stewardship under the Clean Air Act and other laws, we are concerned that EPA and other agencies have at times made unreasonable and often conflicting demands on our members to spend enormous sums to make changes in their manufacturing processes that bring minimal or no environmental benefits.

A Department of Energy report issued in March 2011 concluded that the compounded burden of federal regulations was a significant factor in the closure of 66 petroleum refineries in the United States in the past 20 years (Exhibit A).

The manufacturers of fuels are being hit with a regulatory blizzard that poses a significant threat to both refinery operations and our nation. Some of these regulations involve what are called Tier 3 regulations to reduce sulfur in gasoline, greenhouse gas regulations, lengthy permitting delays, requirements under the Renewable Fuel Standard involving ethanol and other biofuels, and logistical hurdles involved with transporting fuel (such as the Jones Act) to name a

few. While each of these regulations poses significant individual costs, many of these requirements conflict with one another, creating compliance issues and increasing fuel costs.

Tier 3 & CAFE

The Obama administration is claiming it needs to mandate lower sulfur fuels in order to achieve its greenhouse gas (GHG) tailpipe and CAFE standards. These new requirements are referred to Tier 3 gasoline standards. However, since 2004 EPA's Tier 2 rules have reduced sulfur levels in gasoline by 90 percent, from an average of 300 parts per million in 2004 to an average of 30 parts per million today. EPA's own data indicates air quality will continue improving under the existing Tier 2 standards, but EPA has indicated it will advance Tier 3 regulations regardless. Independent analysis indicates Tier III sulfur reductions could result in a 12 to 25 cents per gallon increase in the cost of manufacturing gasoline. In addition, these costs could lead to four to seven refinery closures.

Recent EPA testimony indicating the agency is looking to scale back its Tier 3 proposal and focus solely on sulfur reductions is encouraging and could serve to lessen these costs. Based on the agency's testimony, costs and impacts are likely to fall more towards the lower end of the previously mentioned ranges, if not slightly below. However, the tailored rule would still impose a high-cost, minimal-benefit regulatory requirement on America's already heavily regulated fuel supply. It could still lead to significant domestic fuel supply reductions, higher petroleum product imports, potentially increased consumer costs, increased refinery emissions, closed U.S. refineries and reduced energy security.

A process called hydrotreating is the principal technology used to reduce sulfur in petroleum products, including motor fuels such as gasoline and diesel. This and other such technologies require energy consumption that results in increased GHG emissions and will also

increase emission of other criteria pollutants. As a result, a regulation requiring a reduction of sulfur in petroleum fuel increases emissions that refiners are being told they must reduce under other Clean Air Act (CAA) regulations.

In addition, the Energy Independence and Security Act of 2007 (Section 209) requires EPA to conduct an anti-backsliding study to determine whether mandated renewable fuel volumes will adversely impact air quality. The results of this study are critical to assessing whether or not the current RFS will hamper air quality, as well as how to mitigate such impacts and whether changes to the petroleum portion of the fuel supply are the most cost-effective way to address the issue.

The anti-backsliding study was due in the summer of 2009. It was to be followed up with promulgated regulations to mitigate any potential impacts identified in the study by December 2010. Congress clearly required the study as a precursor to potential regulations, which the statute states should occur 18 months later. However, EPA has not completed this study, but intends to move forward with the Tier 3 proposal anyway.

EPA said it will release the study at the same time it releases its proposed Tier 3 regulations. This is contrary to congressional intent, which clearly indicated the anti-backsliding study was to be completed prior to any new regulations being promulgated. This was to be a sequential schedule, not a concurrent one. EPA should release the study to assess the feasibility of and proper approach to any additional fuels regulations.

EPA GHG Regulations

Although the Clean Air Act (CAA) was never intended to regulate global emissions of greenhouse gases (GHGs), EPA is moving forward in regulating such emissions through the

statute. The agency is proceeding with these regulations even though Administrator Jackson has said several times that they will do nothing to address global concentrations of GHG emissions.

India, China and other growing economies are not imposing the type of carbon restrictions on themselves that EPA is imposing on the American economy. So under EPA's regulations, we will send other countries our jobs and more of our manufacturing base – and those countries will export more manufactured products to America. The previously mentioned EIA report on East Coast refining indicates America's competitiveness is already at risk. As discussed, the report notes supply shortfalls in the Northeast are more likely to be made up through Indian imports than via products from other U.S. refiners. This analysis highlights the fact that America is becoming less competitive in a global marketplace. Overregulation is a significant factor in this threatening trend. Losing American manufacturing jobs and weakening our vital manufacturing sector will harm the American economy and American workers. In addition, the GHG regulations create regulatory uncertainty, delaying construction projects not just in the refining industry but in other important American industries as well.

Permitting Delays

The existing permitting process is delaying important projects for years and adding enormously to their costs, making it less likely that some may be built. The most recent victim of regulatory delay is the Keystone XL pipeline, which has been studied by federal reviewers for more than three years, and which is being required by President Obama to undergo yet further study.

Getting more U.S. and Canadian oil – along with oil from North Dakota and Montana – delivered to Gulf Coast refineries via Keystone XL would add to the world oil supply and make

us less reliant on oil from unstable parts of the world. This would help remove the uncertainty about future supplies that is a factor in the recent rise of oil prices.

Our members were encouraged to hear President Obama express support for construction of the southern leg of Keystone XL from Cushing, Oklahoma to refineries in Port Arthur, Texas to ease a bottleneck in the flow of oil to the Gulf. Unfortunately, the administration has held up approval for the pipeline for over three years. While beneficial for consumers and American energy security, construction of the Cushing leg alone does nothing to get us the oil we need from Canada. Stung by President Obama's refusal to approve the full Keystone XL pipeline until a new study is completed, Canada is now investigating construction of a pipeline from oil sands deposits in Alberta to the Pacific to ship oil to Chinese and other Asian ports.

Turning our back on this Canadian oil and on our trusted friend and dependable ally would be a huge mistake. It would weaken our economic and national security and deprive Americans of tens of thousands of new jobs. It will also make consumers more dependent on crude oil from hostile parts of the world that has historically seen volatile price fluctuations. We call on President Obama to quickly approve the new application that TransCanada intends to file to build the northern portion of Keystone XL from Canada to Oklahoma.

Renewable Fuel Standard (RFS)

Another set of EPA regulations of motor fuels that is causing regulatory conflicts and problems for refiners and consumers involves the size and scope of the ethanol mandate created in the 2007 expansion of the Renewable Fuel Standard. The RFS is costly and unworkable and should be reformed significantly by Congress.

The RFS requires refiners to blend increasing amounts of biofuels in gasoline, reaching 36 billion gallons by 2022. Since it is a volumetric mandate, it does not take into account

whether or not required volumes could actually be used in existing vehicles, engines and infrastructure. Recent increases in CAFE standards compound this issue. According to the National Association of Convenience Stores (NACS), by 2022 every gallon of gasoline sold in the United States would need to contain nearly 40 percent renewable fuels given the new CAFE standards.

The level of blending that would be required to meet both CAFE and the RFS is particularly disconcerting given the infrastructure and compatibility hurdles associated with pushing more ethanol into the general fuel supply. Currently, most cars and light trucks are built to run on gasoline with 10 percent ethanol (E10). However, EPA approved gasoline blends containing 15 percent ethanol (E15) for sale into the general fuel supply in vehicle model years 2001 and later. This proposed 50 percent increase in ethanol blended into the general fuel supply could lead to significant misfueling, causing damage and voiding vehicle warranties In a recent letter to Congressman James Sensenbrenner, the auto manufacturers have expressed concerns that E15 could damage vehicles model year 2001 and later, as well as void consumer warranties as cars and trucks that are designed to use a maximum of E10. Small engine manufacturers have highlighted the adverse impacts mid-level ethanol blends could have on their equipment on several occasions. Furthermore, EPA does not even have the authority to grant a partial waiver under the Clean Air Act, as it clearly states that any fuel or fuel additive "will not cause or contribute to a failure of *any* emission control device or system (emphasis added)." Significantly more testing needs to be conducted and analyzed before E15 can be sold into the general fuel supply, let alone any fuel containing higher ethanol blends.

In addition, higher rates of ethanol in fuel *decrease* fuel economy and make fuel more expensive, even in today's high oil price environment. To highlight this reality, AAA publishes a

daily report of national average fuel prices in its "Fuel Gauge Report." The report includes a BTU adjusted price for E85 that takes into account the fact that the fuel gets approximately 30 percent less fuel economy than gasoline. As of yesterday, the national average regular gasoline price was $3.76. The BTU adjusted price for E85 was $4.23 per gallon.

To make matters worse, EPA charged refiners about $6.8 million in penalties in 2011 for not using enough cellulosic biofuel. But cellulosic biofuel doesn't exist in commercial quantities and *none* was produced last year. So it's *impossible* to use it. If no cellulosic ethanol is manufactured this year, refiners will be charged almost $8.2 million to essentially buy compliance through the purchase of waiver credits. The price of these credits for each gallon of non-existent cellulosic biofuel they don't blend amounted $1.13 per gallon in 2011 and is 78 cents per gallon this year. There is no justification for this hidden energy tax. If allowed to persist, it will simply continue increasing consumer energy costs.

On top of this, some refiners have been victimized by sellers of invalid and fraudulent renewable identification numbers, or RINs. RINs are biofuel credits purchased by refiners to be in compliance with the RFS program. Under the Clean Air Act, EPA is authorized to impose fines of up to $37,500 per day per violation on refiners who use invalid RINs to show compliance with the RFS. The agency can take this action even though refiners believed they were buying valid RINs from sellers registered with EPA. If the maximum fine were imposed every day for a year it would cost refiners millions of dollars.

The current structure and implementation of the Renewable Fuel Standard is based on ideology and political science rather than reality and real science. The program will only work to raise energy costs, impact fuel supplies and threaten American consumers unless modified by Congress.

General Burden of Continuously Tightening CAA and other Environmental Regulations

The $128 billion that U.S. refiners have spent since 1990 to comply with federal environmental regulations adds significantly to their costs of manufacturing fuel. As previously noted, DOE notes the compounded costs of various regulations was a contributing factor to 66 refinery closures since 1990. Refiners supported some of these regulations that were beneficial to the environment. However, we have reached the point where continual tightening of these standards creates an all cost, little to no benefit regulatory environment that threatens the global competitiveness of American fuel manufacturers. Sunoco noted that environmental regulatory costs consumed approximately 15 percent of its operating budget. In addition, the Hovensa refinery that shut down in the U.S. Virgin Islands was located in a region that was in attainment with the Clean Air Act. However, EPA was still going to require the company to make an additional $700 million investment to replace turbines. After losing $1.3 billion in last three years, the refinery couldn't afford the additional regulatory compliance costs. These high regulatory costs that pose little benefit put American refineries at a competitive disadvantage. Finally, ConocoPhillips invested 100 percent or more of its profit into its Trainer refinery in the Philadelphia area to meet regulatory requirements before shutting the refinery last year. The refinery also lost money in five of the last six years.

Regulatory Barriers Contribute to Logistical Problems Involving Transporting Fuel

Regulations also raise barriers to meeting logistical problems associated with moving fuel where it needs to go in this country. For example, the previously mentioned EIA report on Northeast refinery closures explains how the Northeast will likely face a supply shortfall in relation to ultra-low sulfur diesel (ULSD) fuel. ULSD is used as a transportation fuel for trucking, but new mandates in Northeast states will also require the fuel be used for home

heating. Some of the supply shortfall for this product can be made up through shipments from the Gulf Coast to the Northeast through Colonial Pipeline. However, this pipeline is currently at maximum capacity. The report notes the Gulf Coast does have some extra ULSD supply that could serve the Northeast, but the Jones Act requires that any products shipped between ports in the U.S. must travel on U.S.-flagged ships. EIA concludes that in addition to being more costly, there may simply not be enough of these vessels to allow significantly more ULSD volumes to be transported from the Gulf Coast to the Northeast. EIA also concludes that this scenario could result in significantly higher consumer fuel costs in the Northeast.

VI. Conclusion

Because the cost of crude oil accounts for 76 cents of every dollar of gasoline, stabilizing crude oil prices is good not just for American refiners, but for American consumers as well. One important way of doing this would be to increase the supply of crude oil produced right here in the United States and purchased from our close friend and neighbor Canada and brought here via the Keystone XL pipeline. This would show that the U.S. is serious about our energy security and would send a message to the rest of the world.

Contrary to the claims of the critics of fossil fuels, America is not energy-poor. We are energy-rich. There is a treasure trove of oil and natural gas under our feet and off our shores – enough to make America the biggest energy producer in the world. Our challenge is not to find this buried treasure or to extract it, but rather to get federal approval to develop these reserves in a safe and environmentally responsible manner on more federal lands and in more federally controlled waters.

Developing our own oil and natural gas resources would also produce badly needed jobs for American workers and revenue for all levels of government. A study conducted by

consultants Wood Mackenzie and released by API in January found that increasing access by American companies to our nation's oil and natural gas would create 530,000 jobs and generate $150 billion more in government revenue by 2025, at the same time boosting domestic production by 4 million barrels of oil equivalent a day.

Just building the $7 billion Keystone XL pipeline would create 20,000 construction and manufacturing jobs and another 118,000 spin-off jobs for American workers. The Building and Construction Trades Department of the AFL-CIO, the Laborers' International Union of North America, the International Brotherhood of Electrical Workers, the International Union of Operating Engineers, the Teamsters, and the United Association of Plumbers & Pipe Fitters for the United States & Canada all support construction of Keystone XL because it would create so many jobs.

Another way of holding down fuel manufacturing costs would be to reduce the impacts of overregulation, which I have described earlier in my testimony.

We understand that different federal and state regulatory agencies have a hard time balancing the need for effective regulation with the demands of meeting sometimes conflicting decisions from the courts, positions of special interest groups and even newly enacted laws. However, the size, scope, and cumulative burden of current and impending regulatory activity is creating both significant regulatory uncertainty and a slew of conflicting regulations that will impose significant burdens on domestic fuel manufacturers and eventually consumers.

The American people are destined for disappointment and frustration if too many of our leaders continue to be fixated on finding instant solutions to the long-term challenges our nation faces – not just on energy but on all sorts of critical issues. Yet two often, the public policy

debate focuses on a quick fix to some of America's most serious challenges. In reality, accomplishing big things can take years.

For 40 years or more, opponents of fossil fuels have been telling us that opening up more of America for oil and natural gas exploration and drilling isn't worth doing because any single project would take years before it could reach production and get its oil or natural gas to market. Yes, it's impossible to find and start producing oil and delivering it to refineries at lightning speed. But all the projects we were told decades ago would take too long to build could have been up and running and serving Americans for decades by now if they had only been built.

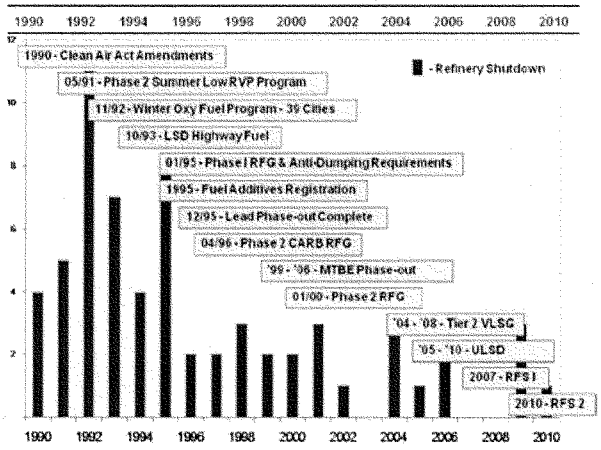
Imagine if the generations that came before us and built America into the great nation it is today had rejected beneficial projects that changed the face of nation because the projects couldn't be completed in a timely manner. Technological advances like the development of the telegraph, the telephone, radio, television, computers and the Internet all required years. None could have been developed it they would have been required to go from the idea stage to the operating stage in a short time period.

Producing more oil and natural gas right here in America, getting more from Canada and reducing harmful overregulation can't take place overnight. But these actions give us our best shot at creating a secure and stable energy supply for American consumers and a manufacturing renaissance and strong job growth in America.

Members of the American Fuel & Petrochemical Manufacturers are eager to work with Congress and the administration to purse this course while protecting our environment to build a better life for Americans today and a better future for the generations that come after us.

Exhibit A

Figure 9. U.S. Refined Product Environmental Regulations 1990-2010



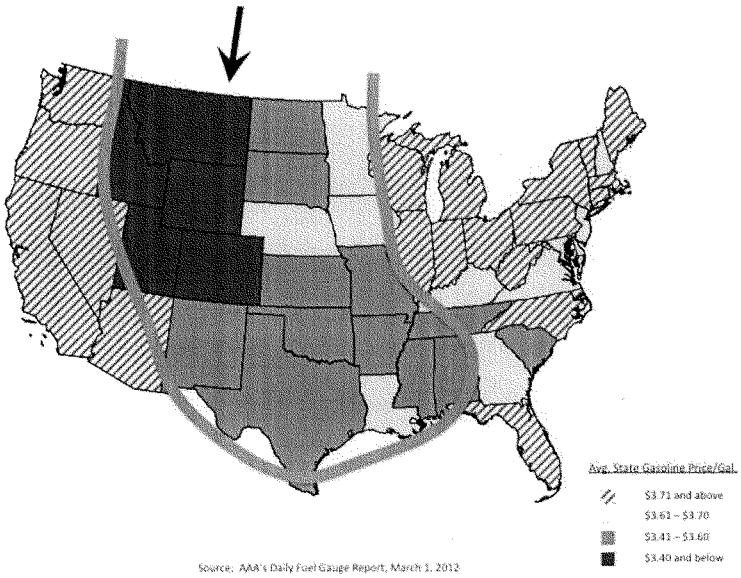
Source: SAIC, 2010, EIA Table 15 - Refineries Permanently Shut Down, 2010.

Source: U.S. Department of Energy, Office of Policy and International Affairs, *Small Refinery Exemption Study – An Investigation Into Disproportionate Economic Hardship*, p. 28-30, found at: http://www.epa.gov/otaq/fuels/renewablefuels/compliancehelp/small-refinery-exempt-study.pdf

Exhibit B

U.S. CONSUMERS PAY LOWER GAS PRICES

WHERE WE GET DISCOUNTED AMERICAN AND CANADIAN CRUDE OIL



Source: AAA's Daily Fuel Gauge Report, March 1, 2012

- **Rocky Mountain States Are Currently Paying $0.50 Less Per Gallon of Gasoline than National Average -** National Avg: $3.74/gal, Wyoming $3.17/gal (-$0.56), Colorado: $3.19/gal (-$0.55), Montana $3.28/gal (-$0.46) (AAA, 3/1/12)

- **Lower Gasoline Prices Due to Access to American and Canadian Crude Oil** -According to a report by the U.S. Energy Information Administration (EIA), low gas prices in Rocky Mountain states are because of their easy access to cheap crude oil produced in the U.S. Bakken region or imported from Canada (EIA, 2/14/12).

- **North American Oil Boom Is Driving Down Prices v. Rest of World** - North American crude oil sells at a discount compared to world prices. West Texas Intermediate (WTI) is averaging $18 less per barrel than the international North Sea Brent price. Bakken crude has sold as much as $28 per barrel less than WTI crude (EIA, 2/29/12).

- **East Coast States Rely on Higher Priced International Crude Supplies -** Because they lack the pipeline infrastructure to access cheaper U.S. and Canadian crude, East Coast refineries must use more expensive international Brent crude to make gasoline (IntlBusinessTimes, 3/1/12).

- **Higher East and West Coast State Gas Taxes Do Not Explain Higher Prices –** For example, New York drivers pay $0.27 per gallon more in state gas taxes than Colorado drivers. Yet, gasoline costs $0.78 more per gallon in New York than Colorado. That is still a $0.52/gal. difference.

Mr. WHITFIELD. Thank you, Mr. Drevna, and Mr. Milburn, we look forward to your testimony. You are recognized for 5 minutes.

STATEMENT OF CHRIS MILBURN

Mr. MILBURN. Thank you. Good morning. My name is Chris Milburn. I am from Hilliard, Ohio, and have been a professional truck driver for close to a decade. I own my own truck and haul retail merchandise while leased to a motor carrier. I am here on behalf of the Owner-Operators Independent Drivers Association, commonly known as OOIDA. OOIDA's approximately 150,000 members are small business truckers from all 50 States. The majority of trucking in this country is small business, as 93 percent of our Nation's motor carriers own 20 or fewer trucks. My testimony will focus on the impact that high energy prices have on small business truckers like me.

I can assure that these impacts are not only very real, but even more significant when you consider them in context with the snowballing cost of regulations coming out of agencies like the Department of Transportation and the Environmental Protection Agency. Just last Monday, the average highway diesel fuel was over $4 per gallon, an increase of 33 cents over 2011. To give you some perspective, the average OOIDA member runs their truck over 100,000 miles each year. At $4 per gallon, annual fuel costs can be well over $80,000. When the price of a gallon of diesel increases by a nickel, a trucker's annual costs increase by $1,000. This results in an extra burden on the small business trucker whose average annual income is approximately 40,000.

Trucking is a hyper-competitive business, and each of us operates on extremely thin margins, so any cost increase, especially those related to fuel or regulatory mandates, has an impact. For me, the impact of fuel costs is best shown through the hundreds of dollars I pay to drive miles that I am not directly compensated for. When price spikes occur, it becomes much more difficult to manage our businesses. However, when prices are not spiking, truckers can take steps to manage these realities. Extra dollars spent on fuel means fewer dollars available to put back into my business. Countless truckers over the years have felt the pain of high fuel prices on their businesses and have had to put off buying new equipment, or worse. For many truckers, business income and family income are basically one in the same. Money isn't available to put towards what is important to their family, including basic household expenses like mortgage payments.

OOIDA has long supported energy policies focused on addressing the impact of energy costs on small business truckers. OOIDA supports a comprehensive approach that combines increasing domestic energy production with other efforts, including greater market transparency, increasing the focus on natural gas as a future energy source, and passing a new surface transportation bill.

Let me talk a little about the role of domestic energy production from the perspective of a small business trucker. In the past, U.S. production has effectively served as a relief valve by helping to mitigate price spikes. However, the strength of that relief has decreased as regulatory roadblocks have reduced domestic production on Federal lands and waters. Impeding domestic production is

something truckers find very difficult to understand, particularly during these high energy prices. Like most truckers, the cost of fuel is far and away my largest annual operating expense. Trust me when I tell you that no government agency is more motivated than I am to make certain that I am running my vehicle as efficiently as possible. I do not need government regulations telling me how to operate efficiently or forcing me to buy a truck that meets some prescribed government efficiency standard, but misses that standard, the operating and efficiency standards I need for my business.

Unfortunately, that is just what happened when EPA completed the first ever fuel efficiency rule for heavy duty trucks. This regulation ignores the collective knowledge of millions of truckers, instead imposing technologies that work for certain types of trucking operations on every one of our Nation's trucking companies. EPA claims this regulation will save each trucker tens of thousands of dollars; however, such a claim is bordering on little more than junk science. There are over 500,000 motor carriers, each running on varied terrain and hauling varied cargo. For many, there is no way this regulations mandates will result in any true fuel savings; yet the only new trucks available after 2014 will be those that comply. Those trucks will cost an additional $6,200 because of these regulations. The truck I have today gets fewer miles to the gallon and is $30,000 more expensive because of EPA mandated emissions reduction equipment and today's diesel fuel costs because of these mandates. We can no longer regulate without recognizing the impact of regulations, and we cannot view regulations as the end all, be all solutions to high fuel prices.

Mr. Chairman, thank you for this opportunity to testify, and I look forward to any questions.

[The prepared statement of Mr. Milburn follows:]

Testimony of

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Before the

COMMITTEE ON ENERGY & COMMERCE
SUBCOMMITTEE ON ENERGY & POWER
UNITED STATES HOUSE OF REPRESENTATIVES

Regarding

THE AMERICAN ENERGY INITIATIVE:
A FOCUS ON RISING GAS PRICES.

MARCH 7, 2012

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On behalf of

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Good morning Chairman Whitfield, Ranking Member Rush, and distinguished members of the Subcommittee. Thank you for inviting me to testify on matters which are extremely important to our nation's small business trucking professionals and professional truck drivers.

My name is Chris Milburn, and I am a member of the Owner-Operator Independent Drivers Association (OOIDA). I live in Hilliard, Ohio and have been a professional truck driver for the past seven years. After twelve years in law enforcement as a deputy sheriff, in 2004, I started in the trucking industry, focusing on fleet management. In 2008, became a full-time trucker, and I currently own my own truck and am leased on to a motor carrier where I spend most of my time hauling retail merchandise.

As you are most likely aware, OOIDA is the national trade association representing the interests of independent owner-operators and professional drivers on all issues that affect small-business truckers. The approximately 150,000 members of OOIDA are small business men and women in all 50 states who collectively own and operate more than 200,000 individual heavy-duty trucks.

The majority of the trucking community in this country is made up of small businesses, as 93 percent of all carriers have 20 or fewer trucks in their fleet and 78 percent of carriers have fleets of just six or fewer trucks. In fact, one-truck motor carriers represent nearly half of the total number of motor carriers operating in the United States.

I have been asked to come here today to speak on behalf of OOIDA and my fellow professional drivers about the impact that high fuel prices are having on the trucking industry, especially small business truckers like me who personally experience the costs of high fuel prices every day when we fill up our trucks and take to the road. Unlike many industries around the country, the trucking industry is not made up of a small number of major entities who can spread increased fuel costs across their business units; for a large part of the trucking community, when a trucking company pays for fuel, it comes out of the operator's pocket.

Sadly, the impact of fuel prices on the livelihoods of truckers is a story we have told to Capitol Hill many times before. Today, as before, the rising cost of fuel – especially coming so early in the year and just as some areas of the country are seeing economic improvements – is increasing the challenges faced by small business truckers.

It is important to note that these price increases do not occur in isolation. Over the past few years, the trucking industry has been laboring under a steadily increasing amount of

regulations from the Department of Transportation, the Department of Homeland Security, and the Environmental Protection Agency. While there is certainly a need for sensible regulation, trucking – especially small business trucking – has been assaulted by a barrage of unnecessary and costly regulation which, when coupled with the rising cost of fuel, are certain to force some small business truckers to park their vehicles. Unfortunately, the answer for many in government to the challenge fuel prices present to truckers is more regulation – instead of common-sense actions like expanding access to American energy.

On behalf of America's small business truckers, I thank the Subcommittee for this opportunity to highlight some actions that OOIDA feels would address the challenges facing our industry from high fuel prices. We recognize that this problem will not be fixed overnight, but steps can be taken now that will have a real impact to small business truckers.

How High Fuel Prices Impact Small Business Truckers

When thinking about how high fuel prices impact the trucking industry, it is easy to think just in the terms of how the largest motor carriers with many trucks in their fleets are impacted. However, while a high fuel bill for one of these mega-carriers may have an impact on their stock price, the impact of a high fuel bill on small business truckers cuts far closer to home.

Just last Monday, the national average for highway diesel fuel jumped to over $4 per gallon, an increase of 33 cents over 2011. To give you some perspective, the average OOIDA member runs their truck over 100,000 miles each year while getting generally somewhere between five to seven miles per gallon depending upon their operation. Most of us will be operating long haul trucks equipped with either twin 135-gallon tanks or twin 150-gallon tanks, so we can easily see a bill of over $1,000 when we fill up. At $4.00 per gallon, our annual fuel costs can be well over $80,000. Whenever the price of a gallon of diesel fuel increases by a nickel, a trucker's annual costs increase by $1,000. Such price increases result in an enormous extra burden on the small business trucker whose average annual income is approximately $40,000.

Trucking is a hyper competitive business and each of us operates on extremely thin margins. Many leased operators like me are paid by the mile, yet the formulas used to calculate our paid mileage is not based on real miles traveled; they are based upon "Household Movers Mileage," a system first started in the 1930s that survives to this day despite accurate systems of

calculating true mileage driven. What this means for me practically is that I am not paid for all the miles I actually drive, which makes cost recovery that much more difficult.

For example, in January I drove 10,843 miles, yet I was only directly paid for 9,645 miles, a difference of just less than 1,200 miles. With my truck, it takes 184 gallons of fuel to drive those 1,200 miles, and with January diesel prices averaging around $3.83, that is a difference of $704 in fuel expenses that I was not directly compensated for.

There is no guarantee that the rate I am paid will cover the full cost of hauling the load. This is an even greater problem for independent owner-operators who may not see the full value of any fuel surcharge added on to their basic freight rate. Additional challenges can come as truckers wait for the payment from a shipper to make its way through the freight broker before it shows up in their bank account. Many truckers purchase fuel on credit, and if they do not have the funds to pay for a previous load's fuel bill, then they cannot purchase fuel for future loads. This structure makes trucking in the era of price spikes extremely risky, especially for small business truckers.

What does this risk mean? Extra dollars spent on fuel means fewer dollars available to put into my business. Countless truckers over the years have felt the pain of high fuel prices on their business. Business expansions have been canceled, truck payments have been missed, and entire trucking companies have gone bankrupt due to the impact that high fuel costs have had on small business motor carriers. Yes, fuel is an expense that can be written off for tax purposes and our industry does have a system of fuel surcharges in place, but when price spikes come suddenly the impact of those structures is significantly reduced, leaving the trucker feeling the full weight of the price increase.

For many small business truckers, business income and family income are basically one in the same. Even if a small business trucker is able to keep their business afloat during times of high fuel prices, money is not going towards things that are important to their family, meaning missed vacations, less savings for their children's college education, or late mortgage payments. And unlike the majority of Americans, most small business truckers do not have unemployment insurance to fall back on should we go out of business.

Like all businesses, small business truckers prefer predictability. We like to have predictable loads, predictable weather conditions and traffic, and most of all, predictable fuel prices. Price spikes, which seem to be occurring more frequently as world political and

economic instability continues, can have especially devastating impacts on truckers, with a few months of high prices taking trucking companies from a position of profitability to a position of bankruptcy.

The price of fuel is something that small business truckers are acutely sensitive to because of the almost immediate and far reaching impact it has on their business and family bottom lines. For that reason, OOIDA has long supported a set of energy policies focused on addressing the impact of higher fuel prices on small business trucker. In fact, OOIDA was founded in 1973 as a result the Arab oil embargoes that literally shut down the trucking industry and nearly crippled the nation. OOIDA's President, Jim Johnston and several other founding members traveled to Washington, DC to present the problems of the trucking industry and common-sense energy solutions before lawmakers. Last spring, the OOIDA Board of Directors updated these solutions as "Principles to Address High Diesel Fuel Prices Impacting Truckers," and I will outline some of these solutions below.

Bringing Back the Relief Valve of Domestic Energy

In the past, domestic energy production has helped mitigate price spikes based on international conditions. It has, in many ways, served as a relief valve ensuring that short term price increases are mitigated and do not have devastating impacts on the trucking industry.

While it is good news that overall domestic energy production is up, we are concerned that, according to recent reports, energy production on federal lands and waters, which contain some of our most plentiful energy supplies, are actually down from the last year by greater than ten percent. With prices this high, truckers like me find it difficult to understand why regulatory and other roadblocks remain to accessing these important American energy resources.

OOIDA supports actions taken by the House last month when it passed important legislation to expand offshore and onshore energy production here in the United States. This legislation represents a common-sense effort to knock down regulatory barriers preventing environmentally sound energy production in places like the Gulf of Mexico and the Mountain West. This will benefit the trucking industry in two ways: 1) by expanding energy by allowing the development of these resources to move forward, and 2) the drilling and refining of these resources must be supported by the trucking industry, as trucks are needed to haul important equipment and supplies.

Additionally, given the myriad of regulations and regulators that small business truckers face, we empathize with small energy producers as they look to locate and develop new sources of energy. Much like truckers, these small producers often operate drilling lease to drilling lease and do not have large international operations to leverage against should government delays slow down their progress. In developing the reforms to the Department of the Interior's energy development process, Congress and the Administration should focus on ensuring that regulatory requirements will achieve their desired intent and not simply add new requirements to industry for the sake of adding requirements. We in the trucking industry have experienced such actions first hand, so we speak from experience.

The Importance of a Comprehensive Approach

Because decreased energy production from federal lands and waters has weakened the relief valve protecting against massive energy price spikes, truckers have felt the pain of what often becomes an irrational market situation, with high amounts of speculation driving up the price of fuel higher and higher.

OOIDA supports efforts to expand transparency of energy trades, and is glad that the Commodity Futures Trading Commission moved forward on these long-delayed rules. However, it is important that we have a variety of approaches to address energy price spikes, as a comprehensive approach will have the best chance of having true success.

The impact of price spikes on trucking goes beyond the time a trucker spends filling up his or her tanks at a truck stop. Seventy percent of our nation's freight – consumer and industrial goods alike – is moved by truck. If companies and consumers are spending more money on energy, that means they are spending less on the things I haul, giving me fewer opportunities to work. Trucking has seen significant challenges over the past few years as industrial and consumer demand has decreased or remained flat. While things are picking up, high energy prices have the ability to significantly hurt our emerging economic recovery.

My time at a truck stop is a perfect example of the impact of energy price spikes on the broader economy. For a trucker, a truck stop is much more than just a place to fuel up. They are where we get our truck washed and where we obtain most of our food and various supplies for the road – just like you might stop at a grocery store tonight on the way home. Those services and extras are how truck stops stay in business, so when folks like me decide not to spend the

money on something like getting our truck washed because we are spending more on fuel, it has an impact on that truck stop, which then has an impact on the local economy, and so on.

Because of the important role that trucking plays in our nation's overall economy, OOIDA also supports efforts to prepare the industry to move to future energy sources. While some may tout the advantages of biofuels, truckers have significant concerns about these fuels, both from a practical operating aspect and from the significant incentives provided to this industry. We are, however, very interested in the increased focus by many towards natural gas and applaud what appears to be growing bipartisan support for the role this fuel can have in powering vehicles, especially local delivery and heavy-duty long haul trucks. Our nation, including my home state of Ohio, has significant natural gas reserves.

Reducing congestion and improving our highways also has an impact on fuel use by truckers. We applaud both the House and Senate for their attention and focus on new surface transportation legislation that will dedicate more dollars back to maintaining and improving our roads and bridges. Trucking provides nearly 40 percent of the revenues for the Highway Trust Fund, and it is important to dedicate as many of those dollars back to our highways as possible.

Increasing the Regulatory Burdens on Truckers: The Wrong Approach

While the solutions to our energy challenges are by no means easy, to truckers like me they are pretty common sense. Unfortunately, instead of making the correct decision, the federal government has followed a path that we in the trucking community are very familiar with – taking the easy route of increasing the regulatory burdens on the trucking industry.

Last September, the Environmental Protection Agency (EPA) and the National Highway Traffic Safety Administration (NHTSA) finalized the first-ever greenhouse gas and fuel efficiency rules of heavy-duty trucks. This regulation came after a decade of EPA regulations on diesel engine particulate and NO_X emissions that have added an additional $30,000 to $50,000 to the price of a new truck while at same time actually reducing fuel efficiency for these vehicles.

These new regulations will, according to agency estimates, add at least an additional $6,200 to the price of a new truck starting in 2014. The experience of OOIDA and others in the trucking industry is that the real price increases related to regulations are significantly higher (EPA underestimated the cost increases of diesel engine regulations during the 2000s by a factor of 2 to 5). While the agencies state that the average trucker will save tens of thousands of dollars

in fuel because of these regulations, there are two significant problems with that argument, problems that significantly undercut the argument for these regulations, especially as the end-all, be-all solution to high fuel prices faced by truckers:

1. Not All Motor Carrier Operations Will See Fuel Cost Savings, Yet All Motor Carriers Will Face the Increased Cost of Regulation

As noted above, the agencies claim significant fuel costs savings from these regulations – given the nature of the trucking industry, such a claim is highly suspect and is bordering on little more than junk science. There are over 500,000 motor carriers in the United States, each with their own business model running on varied terrain and hauling varied cargo. For many of these operations, there is no way the mandates instituted under the regulation will result in any true fuel savings, yet the only new trucks available after 2014 will be those that comply with the regulation and they will be priced accordingly.

For example, a significant portion of the owner-operator community in the United States focus on what is known in the industry as "heavy-haul" operations, where they move oversized and overweight loads that require special equipment and special permits. These are the folks who haul cargo such as equipment for the oil and gas industry, construction and farming equipment, turbines, blades, and towers for wind turbines, and equipment for our nation's armed forces.

These loads are extremely heavy, extremely large, or both, meaning that any potential fuel savings from methods such as changing truck aerodynamics, speed limiters, or special tires will be lost because the load is either so heavy or so large that significant amounts of fuel will be used simply due to the laws of physics. Despite this fact, these one-size-fits-all regulations will force motor carriers to purchase trucks that EPA says will save them vast amounts of fuel when the trucker behind the wheel knows that all these regulations mean is that a new truck is more expensive, and thus further out of reach.

2. The High Cost of Regulation Will Keep Many Motor Carriers from Purchasing New Trucks

OOIDA and its members do not dispute that many of the technologies covered under the EPA's Heavy-Duty Truck Rule will result in fuel savings for specific trucking operations.

Indeed, since the agencies' sole outreach to the trucking industry was to major motor carriers focused on transporting goods from distribution center to distribution center along major highways, these regulations do prescribe add-ons that lead to fuel savings in that type of operation. That is why small and large motor carriers focused on these types of operations have been incorporating these technologies to save fuel, all without any government mandate or regulation.

As highlighted above, if truckers don't drive in a fuel efficient manner, they will drive themselves out of business, as fuel expenses can be 50 percent or more of a truck operator's total revenue before other expenses like truck payments, insurance, maintenance, and taxes. Despite the significant market forces in play, the EPA feels that truckers cannot figure out how to reduce fuel use and costs on their own without the government showing them the way through new regulatory mandates.

For truckers, these regulatory mandates are not free. There is a cumulative cost of these regulations plus a decade's worth of diesel emission regulations, and potential new mandates from the Department of Transportation. All of these new regulatory mandates are pushing the cost of a new truck higher and higher, placing that purchase far out of the reach of all but the largest carriers and most successful owner-operators.

This leads to significantly reduced environmental benefits from the regulation, putting truckers at risk of being put into a never-ending cycle: Regulations are implemented by Washington, but they do not achieve the anticipated results in improving fuel economy; Washington decides that further regulations are necessary, driving the price of new trucks even higher; this new round of regulation also does not achieve Washington's goals, putting truckers at the mercy of a constantly repeating record. The irony in this situation is that a major reason for the reduction in truck fuel economy during the 2000s was the diesel emissions regulations mandated by EPA increased fuel use by 5-9 percent. Truckers are being forced by EPA to pay extra to potentially regain fuel economy that previous EPA regulations took from them.

Conclusion

Mr. Chairman and members of the Subcommittee, small business truckers are the front line in feeling the impact of energy price spikes like those we are experiencing today. As these

high prices continue into the spring and summer, truckers will feel the pain and for some, the costs will become too great.

As professional drivers, we see the impact of high fuel prices every day. Unfortunately, today's high fuel costs are only adding to the challenges imposed upon the industry from numerous, costly government regulations. These challenges not only rob small business truckers of the ability to maintain and grow their business, but also decrease the incomes of hundreds of thousands of families around the country. OOIDA looks forward to working with this Subcommittee and the entire Congress to find solutions to our nation's energy challenges while reducing burdensome regulations on small business truckers.

Thank you for the opportunity to testify today on this important topic, and I look forward to answering any questions from the Subcommittee.

Mr. WHITFIELD. Thank you, Mr. Milburn.

Mr. Weiss, you are recognized for 5 minutes for an opening statement.

STATEMENT OF DANIEL J. WEISS

Mr. WEISS. Thank you, Mr. Chairman, Ranking Member Rush, and members of the subcommittee. Thank you very much for the opportunity——

Mr. WHITFIELD. I am sorry, I am not sure your microphone is on, Mr. Weiss.

Mr. WEISS. Sorry. OK. Do I get the seconds back on the clock? Just kidding. It is like the referee putting the time back on a football game.

My name is Daniel J. Weiss. I am a senior fellow at the Center for American Progress, which is a progressive think tank.

The question is why are there high oil and gasoline prices in 2012? There has been no major supply disruption at home or abroad. Wall Street speculators are preying on commercial end users' fears of such an interruption to drive up prices and make a profit. An analysis by McClatchy Newspapers found that these speculators are making nearly 2/3 of the trades compared to 1/3 of the trades by end users of oil. The Washington Post just yesterday found that "Many analysts agree that trading activity is pushing up oil prices over and above what supply and demand would normally dictate." Last year, the CEO of ExxonMobil told the Senate that the oil price was $30 to $40 higher than supply and demand would indicate.

Now this oil and gasoline price spike that we are experiencing now is not a first time event. Fortunately, we can better withstand its impact because of President Obama's leadership. We are using the least amount of oil in 11 years due to the vehicle fuel economy standards adopted in 2009. We are also producing the most oil in at least 8 years, 13 percent more since President Obama took office. If we could go to the slide, that would be great.

[Slide.]

The U.S. has more oil and gas rigs than the rest of the world combined. As you can see, the blue line at the bottom is the increase in number of rigs, the red line at the top shows that gasoline prices. And as you can see, even as the number of rigs we have in operation has climbed dramatically, the price of gasoline has also climbed. The—in addition, the Interior Department reports that 3/5 of the leases for oil held on public lands are undeveloped and there are also thousands of leases in the western Gulf of Mexico that are held but undeveloped. Fortunately, for the first time in 15 years, the U.S. produces a majority of its oil, but because oil is prices on the global market led by the OPEC cartel, more production here does not lower prices and growing worldwide demand can offset our lower consumption.

There are no quick fixes to reduce high oil or gasoline prices. In 2008, President George W. Bush said "If there was a magic want to wave, I would be waving it to lower prices." President Obama agreed. "There are no silver bullets short-term when it comes to gas prices, and anybody who says otherwise isn't telling the truth." He noted that the United States uses 20 percent of the world's oil,

but only has 2 percent of the reserves. Instead, an "all of the above" strategy is necessary and should feature investments in modern fuel economy standards, alternative fuels, and public transportation. Ultimately, we have to lower our dependence on oil.

Reducing oil use saves families money. The next improvement of fuel economy standards will reduce oil use by more than two million barrels a day. Modern 2025 cars will go twice as far on a gallon of gas, and will save their owners $8,000 and lower gas purchases compared to 2010 cars. Additionally, Congress should pass bipartisan bills to invest in electric passenger vehicles and natural gas powered trucks, the bill sponsored by Mr. Sullivan.

But instead of investing in such innovative technologies, we fund $40 billion per decade in tax breaks for big oil companies. Recipients include BP, Chevron, ConocoPhillips, ExxonMobil and Shell, which made a combined profit of $137 billion in 2011 while they produced 4 percent less oil. In 2005, President Bush supported ending oil tax incentives. "I will tell you, with $55 oil, we don't need incentives for the oil and gas companies to explore. There are plenty of incentives."

As Mr. Whitfield said earlier—Chairman Whitfield said earlier, we need to provide immediate assistance to help consumers. One way to do that for the short-term is to sell a small amount of oil from the nearly full Strategic Petroleum Reserve in coordination with sales from international reserves. Past sales have lowered oil and gasoline prices every time, even when the Congress under Speaker Gingrich in 1996 sold reserve oil to reduce the deficit. Such a sale would burst the bubble caused by Wall Street speculators driving up prices for a quick profit. Additionally, the Dodd-Frank law includes potent weapons to limit these speculators" ability to dominate the market, and it should be fully implemented and enforced. One more thing about the Keystone pipeline. The State Department found that building the pipeline would not have an impact on crude oil supplies or prices.

Today's hearing on high gasoline prices is like the rerun of a bad movie. It is up to you to change the ending. The American people would give you a standing ovation.

Thank you.

[The prepared statement of Mr. Weiss follows:]

Center for American Progress

Testimony before the House Energy and Commerce Committee

Subcommittee on Energy and Power

U.S. House of Representatives

March 7, 2012

Daniel J. Weiss, Senior Fellow and Director of Climate Policy

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Statement of
Daniel J. Weiss, Senior Fellow and Director of Climate Policy
Center for American Progress
March 7, 2012

Chairman Whitfield, Ranking Member Rush, and members of the subcommittee, thank you very much for the opportunity to testify today on "The American Energy Initiative: A Focus on Rising Gas Prices."

My name is Daniel J. Weiss. I am a Senior Fellow at the Center for American Progress Action Fund, which is a progressive think tank started by John Podesta, chief of staff to former President Bill Clinton and co-chair of President Barack Obama's transition team.

The recent spike in oil and gasoline prices is not a first-time event. It has occurred twice previously in the past four years. Fortunately, we are better prepared to withstand its impact because we are using less oil due to the vehicle fuel economy standards adopted by President Obama in 2009.

We are also producing more of our own oil. For the first time since President Clinton, the United States is producing a majority of the oil we rely on to power our vehicles and economy. We are less reliant on other nations for oil and send less of our treasure abroad.

This progress, however, cannot mask the fundamental fact that we rely too much on a single fuel and are thus extremely vulnerable to volatile prices or international events beyond our control. To end the oil price rollercoaster that inflicts real damage to our economy and middle class, we must dramatically curtail our reliance on oil as our primary transportation fuel.

As you know, high oil and gasoline prices slow economic growth and take a real toll on families' already-strained budgets. Unlike many other commodities, demand for gasoline does not significantly decrease even as prices increase because most people cannot quickly and significantly reduce the amount they drive by changing jobs or buying a new home.

Our last two presidents recognized that there are no quick fixes to reduce high oil or gasoline prices. In 2008 President George W. Bush said that "if there was a magic wand to wave, I'd be waving it" to lower prices.

Last month President Obama said that "there are no silver bullets short term when it comes to gas prices—and anybody who says otherwise isn't telling the truth." He also noted that the United States uses 20 percent of the world's annual oil consumption but has only 2 percent of the reserves.

In lieu of wands, bullets, or slogans, this long-term problem requires long-term solutions. We need a long-term "all of the above" strategy that generates long-term investments in modern fuel economy standards, alternative fuels, and public transportation that can reduce our vulnerability to future oil and gasoline price spikes.

In 2005 President Bush supported this idea when he said, "I will tell you with $55 oil, we don't need incentives to the oil and gas companies to explore. There are plenty of incentives. What we need is to put a strategy in place that will help this country over time become less dependent."

President Obama has demonstrated leadership in using less and producing more oil. In 2011, we consumed the least amount of oil since early 2001, and even more savings are imminent as we implement modern vehicle fuel economy standards. We are producing the most oil in at least eight years. In addition, the administration and many in Congress have supported investments in alternative-fuel vehicles, particularly electric passenger vehicles and natural-gas-powered trucks. Congress must act on these proposals.

Unfortunately, the pending House transportation bill would disinvest in public transportation—something that's essential to us using less oil and protecting families from high gasoline prices. While withholding investments for alternatives to oil, we continue tax breaks for Big Oil companies even though the price of oil is nearly double compared to when President Bush said that such support was unnecessary.

This includes tax breaks for the big five oil companies—BP, Chevron, ConocoPhillips, ExxonMobil, and Shell—which made a record $137 billion in profits in 2011 while they produced 4 percent less oil. It makes little sense to continue $4 billion in annual oil and gas tax breaks for oil and gas companies. Instead, we should invest these revenues in helping Americans reduce their oil and gasoline use and save money.

There is a proven tool to provide some temporary relief now from high prices. Selling a small amount of oil from the Strategic Petroleum Reserve in coordination with sales from International Energy Agency reserves would boost world oil supplies. Such a sale has occurred under the last four presidents and has lowered oil and gasoline prices every time. This can cut prices and burst the "bubble" caused by Wall Street speculators driving up oil prices for a quick profit.

Finally, the Commodities Future Trading Commission must finalize the position limits on large Wall Street speculators to reduce their impact on volatile, high oil prices.

Today's hearing on high gasoline prices is like the rerun of a bad movie. It's up to you to change the finale. Congress must slash oil dependence by supporting the doubling of vehicle fuel economy standards, investing in alternative fuels, rejuvenating our public transportation infrastructure, and paying for it by ending Big Oil tax breaks. The American people would give this ending a standing ovation.

This written testimony builds upon the analysis of Center for American Progress and Center for American Progress Action Fund colleagues Richard Caperton, Michael Conathan, Donna Cooper, Pat Garofalo, Jessica Goad, Christy Goldfuss, Kate Gordon, Seth Hanlon, Brad

Johnson, Tom Kenworthy, Kiley Kroh, Stephen Lacey, Rebecca Leber, Rebecca Lefton, Noreen Nielsen, John Podesta, Joe Romm, and Jackie Weidman. The work of then-CAP colleagues Sima Ghandi and Valeri Vasquez also contributed to this testimony. Any errors are the author's alone.

Why are oil and gasoline prices so high?

On January 2 the price of a barrel of West Texas Intermediate, or WTI, crude was $103 per barrel. On February 28 WTI cost $107 per barrel—a $4 or 4 percent increase. Brent oil on the European market rose from $111 to $124 during this time—a 12 percent jump.

Gasoline averaged $3.78 per gallon for the week ending February 27—an increase of 42 cents or 13 percent—since the New Year. The Energy Information Administration, or EIA, reports that in January 2012, the price of crude oil was responsible for three-quarters of the cost of a gallon of gas. When oil prices climbed, so did gasoline prices.

One obvious source of higher prices is tension in the Persian Gulf. Sanctions on Iran meant to convince it to abandon its quest to develop a nuclear weapon led it to "rattle its saber" by threatening to prematurely cut off its oil exports to Europe and other nations—those that will cease buying Iranian oil as of July 1. For instance, on February 19 Iran announced that it would stop oil sales to England and France. Although these two nations buy very little Iranian oil, fear that Iran would stop supplying other more dependent countries boosted the spot price for oil by $3 per barrel overnight.

The Congressional Research Service concurred with this assessment. Its report, "Rising Gasoline Prices 2012,"[1] determined that, "In early 2012, developments around Iran and their implications for global oil supply have been a key factor in recent oil and gasoline price changes."

The production decline in Libya due to the successful war to oust Muammar Gaddafi continues. According to CBS News:

> Libya says it has boosted oil production to 1.4 million barrels per day in February, in a sign that the country is inching closer to pre-civil war output levels. The Oil Ministry says that figure is 100,000 barrels per day higher than the previous month.

This is 12 percent less than Libya's prewar production of 1.6 million barrels per day.

In a February 29, 2012, report to Congress, EIA concluded the world oil market has tightened in 2012 due to more demand and supply interruptions:

> Global liquid fuels consumption is at historically high levels. ... continued growth [in Europe] is expected. Unusually cold weather in Europe contributed to tighter markets by increasing the demand for heating oil, particularly during February.
>
> The world has experienced a number of supply interruptions in the last two months, including production drops in South Sudan, Syria, Yemen, and the North Sea. Both the United States and the European Union (EU) have acted to tighten sanctions against Iran. ... there is some evidence that these measures may already be causing some adjustments in oil supply patterns.

Wall Street speculators drive up prices

Tension in the Persian Gulf and minor supply disruptions are not the sole cause of high oil and gasoline prices. This is also evidence that Wall Street speculators are taking advantage of fears about future supply disruptions to drive up prices. *Bloomberg Businessweek* noted that, "Strangely, the current run-up in prices comes despite sinking demand in the U.S." It cites Tom Kloza, chief oil analyst for the Oil Price Information Service, who says that speculators are helping to drive up oil prices:

> Much of the increase is due to speculative money that's flowed into gasoline futures contracts since the beginning of the year, mostly from hedge funds and large money managers. "We've seen about $11 billion of speculative money come in on the long side of gas futures," [Kloza] says. "Each of the last three weeks we've seen a record net-long position being taken."

An analysis of oil trades by *McClatchy* newspapers concluded that Wall Street speculators are "behind sharply rising oil and gas prices." It determined that:

> While tension over Iran has ratcheted up over the last few months, the price of oil and gasoline has leaped far beyond conventional supply and demand variables. Financial speculators are piling into the market, torqueing the Iranian fear factor into ever-higher prices.
>
> Historically, financial speculators accounted for about 30 percent of oil trading in commodity markets, while producers and end users made up about 70 percent. Today it's almost the reverse.
>
> A McClatchy review of the latest Commitment of Traders report from the Commodity Futures Trading Commission, which regulates oil trading, shows that producers and merchants made up just 36 percent of all contracts traded in the week ending Feb. 14.
>
> That same week, open interest, or the total outstanding oil contracts for next-month delivery of 1,000 barrels of oil (about 42,000 gallons), stood near an all-time high above 1.486 million. Speculators who'll never take delivery of oil made up 64 percent of the market."

The role of Wall Street speculators driving up prices in 2012 is consistent with evaluations of previous price spikes. Commodity Futures Trading Commissioner Bart Chilton recently cited numerous independent studies that indicate excessive Wall Street speculations played a significant role in earlier events.

On March 6, the *Washington Post* examined whether speculation is driving up oil prices. It found that

> "Many analysts agree that trading activity is pushing up oil prices over and above what supply and demand would normally dictate — and much of this has been driven by fear

> over a possible conflict with Iran. 'Speculation has inflated oil prices by more than 30%,' says Fadel Gheit, an oil analyst at Oppenheimer & Co.
>
> "That's in line with other estimates: A recent paper (pdf) by the Federal Reserve Bank of St. Louis found that 'financial speculative demand shocks' were responsible for at least 15 percent of the huge run-up in oil prices between 2004 and 2008."

Oil executives also understand that Wall Street speculation drives up oil prices. At a hearing before the Senate Finance Committee on May 12, 2011, Sen. Maria Cantwell (D-WA) asked ExxonMobil CEO Rex Tillerson, "What do you think the price would be today, if it was based on fundamentals of just supply and demand?" He responded: "it's going to be somewhere in the $60 to $70 range." At the time of the hearing, WTI crude oil was selling for $98 a barrel—55 percent to 63 percent more than Tillerson's predicted range.

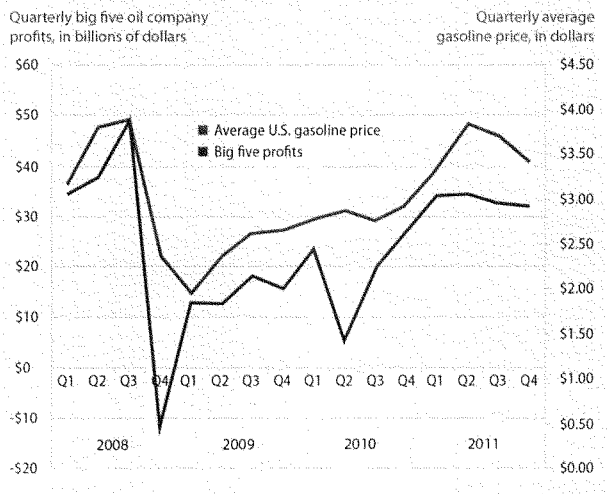
Higher gasoline prices means higher profits for Big Oil companies

Higher gas prices mean that money is flowing out of Americans' wallets and pocketbooks and straight into the coffers of Big Oil companies. A recent Center for American Progress analysis, "Pumped and Quartered: As American Families Pay 25 Cents More for a Gallon of Gas, Big Oil Earns $5 Billion More in Profits," quantified this phenomenon. It found that each 1 cent rise in the average quarterly, or three-month, price of a gallon of gas corresponds to a $200 million increase in quarterly profits of the big five oil companies—BP, Chevron, ConocoPhillips, ExxonMobil, and Royal Dutch Shell.[2]

CAP analyzed the past four years of average quarterly gas prices and total profits for the five largest oil companies and not surprisingly, oil company profits are closely linked to gas prices. While gas prices aren't the only factors influencing profits, they are a significant indicator. What's more, we can confidently predict how much money each penny increase in gas prices transfers from consumers to the big five oil companies.

FIGURE 1

Oil profits increase when gas prices go up



Source: Energy Information Administration; BP, Chevron, ExxonMobil, Royal Dutch Shell, and ConocoPhillips Quarterly Profit Reports

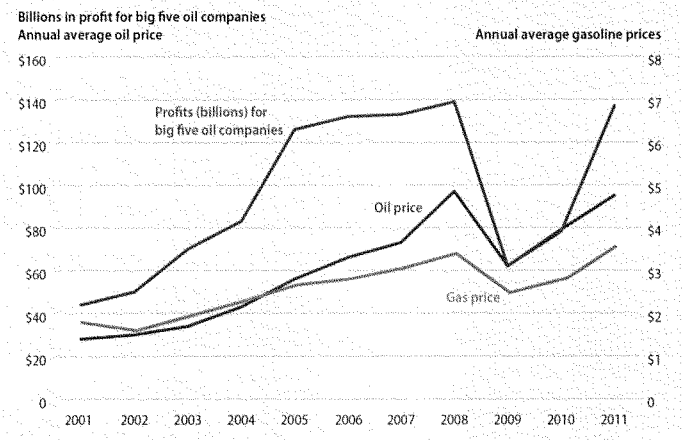
Big Oil made record profits in 2011: Billions in tax breaks unnecessary

In 2011 the five largest oil companies combined made a record-high $137 billion in profits—up 75 percent from 2010. They made $1 trillion in profits from 2001 through 2011.

FIGURE 2

Higher prices help Big Oil

Big five oil companies' profits versus oil and gas prices



*All figures in 2011 dollars **2010 profits lower due to BP's Gulf oil spill, decreasing the company's profits by tens of billions of dollars
Sources: EIA and company profit reports

A CAP analysis, "Big Oil's Banner Year," identified these highlights from the big five's activities in 2011 (see figures 3 through 6):

- They produced 4 percent *less* oil and "oil equivalent" in 2011 compared to 2010.
- They spent a total of $38 billion—or 28 percent—of their profits to repurchase their own stock.
- They are sitting on more than $58 billion in cash reserves as of the end of 2011.
- They spent $1.6 million on campaign contributions and $65.7 million on lobbying efforts.
- For every $1 spent on lobbying in Washington, the big five received $30 worth of tax breaks.

FIGURE 3

Profits up, production down

Big Oil's profits soar as oil-equivalent production decreases from 2010 to 2011

Company	Total profit, 2010 (in billions)	Total profit, 2011 (in billions)	Percent increase in profit from 2010 to 2011	Oil-equivalent production, 2010 (millions of barrels per day)	Oil-equivalent production, 2011 (millions of barrels per day)	Percent change in production from 2010 to 2011
BP	$(4)	$26	114%	3.8	3.5	-10%
Chevron	$19	$27	42%	2.8	2.7	-3%
ConocoPhillips	$11	$12	9%	1.9	1.7	-9%
ExxonMobil	$31	$41	31%	4.4	4.5	1%
Shell	$20	$31	54%	3.3	3.2	-3%
Total	**$78**	**$137**	75%	**16.2**	**15.6**	**-4%**

Source: Company profit reports

FIGURE 4

Big Oil helps itself

Total stock repurchases by company, 2011

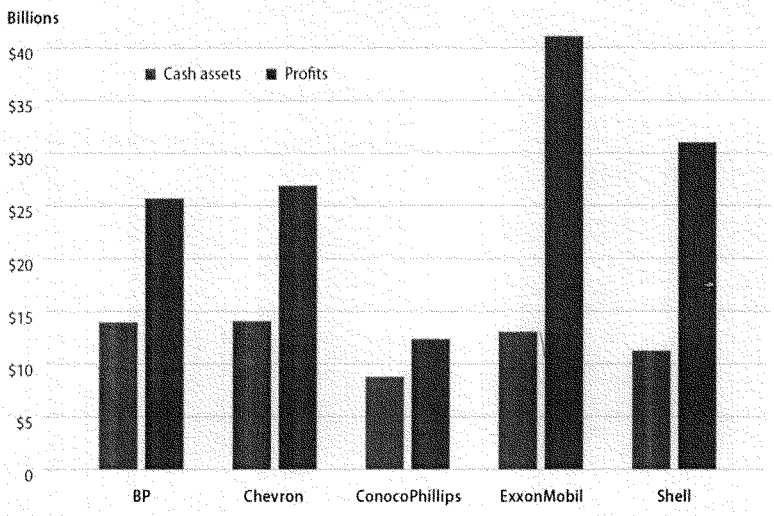
Company	Total profit, 2011 (in billions)	Total stock repurchase, 2011 (in billions)	Percentage of 2011 profit used for repurchase
BP	$26	-	-
Chevron	$27	$4	16%
ConocoPhillips	$12	$11	89%
ExxonMobil	$41	$22	53%
Shell*	$31	$1	4%
Total	**$137**	**$38**	**28%**

Source: Company profit reports

FIGURE 5

Big Oil doesn't need their tax breaks

Cash assets and profits by company, 2011



*Cash assets as of December 2011

Source: Company profit reports

FIGURE 6

Big Oil woos Congress

Lobbying expenditures and campaign contributions in 2011

Company	Lobbying (in millions)	Campaign contributions
BP	$8.1	$98,804
Chevron	$9.5	$467,996
ConocoPhillips	$20.6	$216,365
ExxonMobil	$12.7	$872,694
Shell	$14.8	-
Total	**$65.7**	**$1,655,859**

*Royal Dutch Shell has not yet made any 2011-2012 campaign contributions.
Source: "Lobbying Spending Database Oil & Gas, 2011," available at http://www.opensecrets.org/lobby/indusclient.php?id=E01&year=a.

Big Oil receives billions of dollars in unnecessary tax breaks

The tax code has numerous breaks big for oil and gas companies. These are simply subsidies that are delivered through the tax code, but they are essentially no different from government spending programs that provide money directly.

Here's a summary of the major oil and gas tax breaks and their cost to taxpayers over a decade:[3]

- Percentage depletion: $11.2 billion
- Domestic manufacturing deduction for oil production: $18.2 billion
- Expensing of intangible drilling costs: $12.5 billion
- "Dual-capacity taxpayer" rules for claiming foreign tax credits: $10.8 billion
- Amortization of geological and geophysical expenditures: $1.4 billion
- "Last-in, first-out" accounting for oil companies: as much as $22.5 billion

An analysis by Citizens for Tax Justice, "Corporate Taxpayers & Corporate Tax Dodgers 2008-10," determined that biggest U.S. oil and gas companies paid an average effective federal income tax rate of 15.7 percent from 2008 to 2010.[4] This compares favorably to

> "The average effective tax rate for all 280 companies [studied] was only 18.5 percent. For the past two years, 2009 and 2010, the effective tax rate for all 280 companies averaged only 17.3 percent, less than half of the statutory 35 percent rate."

The American Petroleum Institute, or API, claims that eliminating these tax loopholes for the oil and gas industry would "lose jobs … and energy production." Yet higher oil prices and profits, combined with huge reserves and tax breaks, yielded lower, not higher, employment and oil production.

In 2011 the Democrats on the House Natural Resources Committee released "Profits and Pink Slips: How Big Oil and Gas Companies are Not Creating U.S. Jobs or Paying Their Fair Share." This report revealed:

> Despite generating $546 billion in profits between 2005 and 2010, ExxonMobil, Chevron, Shell, and BP combined to reduce their U.S. workforce by 11,200 employees over that time.

Nor are many of these net revenues used for oil production. The report found that "among the Big 5 oil companies, less than 10 percent of profits are reinvested into exploration of new oil deposits."

The report also concluded that:

> The oil and gas industry is a mature and highly profitable sector that is no longer in need of generous tax breaks or royalty free drilling. The $43.6 billion in tax subsidies that the industry is set to receive over the next decade will not help consumers with rising energy costs.

Tax breaks to Big Oil same as government grants

These tax breaks are "tax expenditures" that provide taxpayer-funded subsidies to Big Oil companies via the federal tax code instead of through direct grants. Whether in the form of special exemptions, deductions, or credits, these loopholes are essentially federal spending programs administered by the Internal Revenue Service.

Big Oil and their lobbyists will falsely cry "tax hike" should Congress attempt to remove these special interest provisions to reduce the deficit. The dollar amount given out to each company is kept hidden since IRS information is not made public.

Economists have recognized that there is no meaningful difference between tax expenditures and programs that spend money directly. Whether that annual $4 billion subsidy for oil and gas—at a time when oil companies are posting huge profits—is spent directly or through special tax code provisions, the end result is that the oil companies are $4 billion better off every year—and the federal deficit is $4 billion larger every year.

Fortunately, the fact that tax expenditures are government spending is recognized more and more by conservative economists and politicians. Former President Ronald Reagan's chief economic advisor, economist Dr. Martin Feldstein, noted that:

> These tax rules—because they result in the loss of revenue that would otherwise be collected by the government—are equivalent to direct government expenditures. If Congress is serious about cutting government spending, it has to go after many of them. Cutting tax expenditures is really the best way to reduce government spending.

Former Senate Budget Committee Chair Pete Domenici (R-NM) and former Congressional Budget Office Director Dr. Alice Rivlin agree:

> Many tax expenditures substitute for programs that easily could be structured as direct spending. When structured as tax credits, they appear as reductions of taxes, even though they provide the same type of subsidy that a direct spending program would, and like a spending program, must be financed either by tax increases, cuts in other spending programs, or increases in the deficit that pass the cost to future generations.

House Ways and Means Committee Chair Dave Camp (R-MI) agreed that tax breaks are another way of providing direct support for industry:

> [W]e must admit that not all of [recent] spending has been through increased appropriations or expanded entitlements; much of it has been through the backdoor proliferation of "tax expenditures"—provisions that technically reduce someone's tax liability, but that in reality amount to spending through the tax code.

Before becoming speaker of the House, Rep. John Boehner (R-OH) echoed this belief:

> We need to take a long and hard look at the undergrowth of deductions, credits, and special carve-outs that our tax code has become. And yes, we need to acknowledge that what Washington sometimes calls tax cuts are really just poorly disguised spending programs that expand the role of government in the lives of individuals and employers.

In 2011 Speaker Boehner reiterated his concern about them in an interview with ABC News:

> It's certainly something we should be looking at. We're in a time when the federal government's short on revenues. We need to control spending but we need to have revenues to keep the government going. They ought to be paying their fair share.

Last year, ConocoPhillips CEO Jim Mulva testified before Congress, saying that, "with respect to oil and gas exploration and production, we do not need incentives."

Revenue from Big Oil tax breaks could benefit middle class instead

Seventy-four percent of Americans agree with the president's desire to eliminate tax breaks for the oil and gas industry. They understand that there are more important priorities than assisting some of the most profitable companies in the world.

Instead of benefiting oil companies that reward senior executives, board members, and stockholders, these taxpayer funds should be invested in projects that benefit all Americans. A University of Massachusetts study found that investment in clean energy creates anywhere from two to four times more direct and indirect jobs compared to the same investment in oil and gas production.

Let's put these tax breaks in context. In 2011 the House-passed FY 2012 budget would have cut Medicare funding by $30 billion over 10 years. Ending these tax breaks would save $40 billion over that same time period.

On an annual basis, ending the $4 billion in annual tax breaks for big oil and gas companies could pay for:

- The salaries of 72,000 high school teachers earning an average of $55,000 per year
- Pell Grants for more than one million aspiring college students
- Solar energy systems for 135,000 homes, costing an average of $15,000, which would reduce carbon dioxide pollution by 175,000 metric tons annually

Last September while addressing economic growth and deficit reduction, President Barack Obama noted that as we cut federal program funding to reduce the budget deficit, "Either we gut education and medical research, or we've got to reform the tax code so that the most profitable corporations have to give up tax loopholes that other companies don't get. We can't afford to do both."

Independent analyses debunk Big Oil's defense of tax breaks

As to be expected, Big Oil will not give up its tax breaks without a fight, even if it means paying for junk analysis by hired guns. Some Big Oil allies claim that eliminating tax breaks for Big Oil companies will increase oil and gasoline prices. The Congressional Research Service debunked this false claim, finding that "there is little reason to believe that the price of oil, or gasoline, consumers face will increase" from an end to subsidies.

Another example is the 2011 release of "Repealing Tax Deductions on U.S. Energy Companies Exacerbates Federal Deficit, Increases U.S. Debt" by Joseph Mason, a professor at Louisiana State University. The report was "prepared with the support of the American Energy Alliance," which receives oil industry funds. The study unabashedly relies on other oil-industry funded research to buttress its false claims.

In the report Mason attempts to evaluate the impact of eliminating two special subsidies enjoyed by the oil industry:

- Domestic manufacturing deductions for oil production under Section 199 of the U.S. tax code
- The treatment of so-called "dual capacity taxpayers" who claim foreign tax credits, including oil companies

These are both arcane tax loopholes that reaped oil companies $29 billion over the past decade. Section 199 is the domestic manufacturing deduction designed to help beleaguered manufacturers by providing an incentive to keep their facilities and jobs in the United States. Big Oil successfully lobbied to be included in this tax break, but it should not apply to oil companies for several reasons. These include the capital-intensive nature of oil production, the relative mobility of investments, and, of course, the level of profitability—there are vast differences between the oil industry and traditional U.S. manufacturing.

Dual-capacity taxpayer rules for claiming foreign tax credits allow companies that do business abroad to deduct from their tax bill any income taxes paid to other governments. The rules are supposed to prevent oil and other companies from claiming credit for royalty payments to foreign governments, which are fees for the privilege of extracting natural resources. But the current rules have been significantly weakened so that now oil companies can reap credits on "taxes" that are, in substance, royalty payments for extracting oil.

Mason's claims that eliminating these two oil company tax breaks would increase the federal budget deficit were debunked by multiple independent government analyses. The Congressional Budget Office, or CBO, working with the Congressional Joint Committee on Taxation, determined that:

> The other revenue proposals in the President's budget whose effects are included in this analysis would raise revenues by $174 billion, on net, over the next 10 years [include] ... reducing tax preferences for the production of fossil fuels ($41 billion).

An earlier Joint Committee on Taxation, or JCT, analysis of removal of the Section 199 tax deduction also found that it would generate federal revenue and reduce the deficit.

> The Joint Committee on Taxation estimates that removal of the [Section 199] credit for major integrated oil and gas producers would bring in $9.433 billion in federal revenue over the next eleven years.

The U.S. Department of Treasury's "General Explanation of the Administration's Fiscal Year 2012 Revenue Proposals"—known as "The Greenbook"—also determined that eliminating these provisions would generate revenue. The analysis found that eliminating Section 199 provision would generate $18.3 billion over a decade (see page 147 of the report) and modifying the dual capacity rules would generate $10.8 billion through 2021 (page 146), for total savings of $29.1 billion. (The CBO and JCT also estimate that the president's international tax proposals, including the "dual-capacity taxpayer" reform, would raise a combined $133 billion over 10 years.)

The Congressional Research Service also recently concluded that ending these two (and other) tax breaks for the five largest oil companies would raise billions of dollars of revenue.

The bottom line: Unbiased revenue estimators at four government agencies all drew the same conclusion—eliminating these two tax breaks for Big Oil companies would generate billions of dollars in revenue for the federal government.

How does Louisiana State University's Mason come to a different conclusion? It may be due to his false assumptions about the Obama administration's energy policies. He wrongly claims that it is the administration's policy to "creat[e] a tax drag on economic growth in an attempt to engineer a social shift away from fossil fuels." So at every decision point he incorrectly assumes that the administration's goal is to keep oil prices high and production low.

But there is a more fundamental reason why Mason's report reaches the opposite conclusion from four government entities. Much of his analysis relies on previous claims made by Big Oil-funded organizations. In his paper there are more than two-dozen references to the views of the American Petroleum Institute, officials from specific oil companies, the Institute for Energy Research, and the American Energy Alliance, or AEA. All of them produce conflicted research due to the source of their funding.

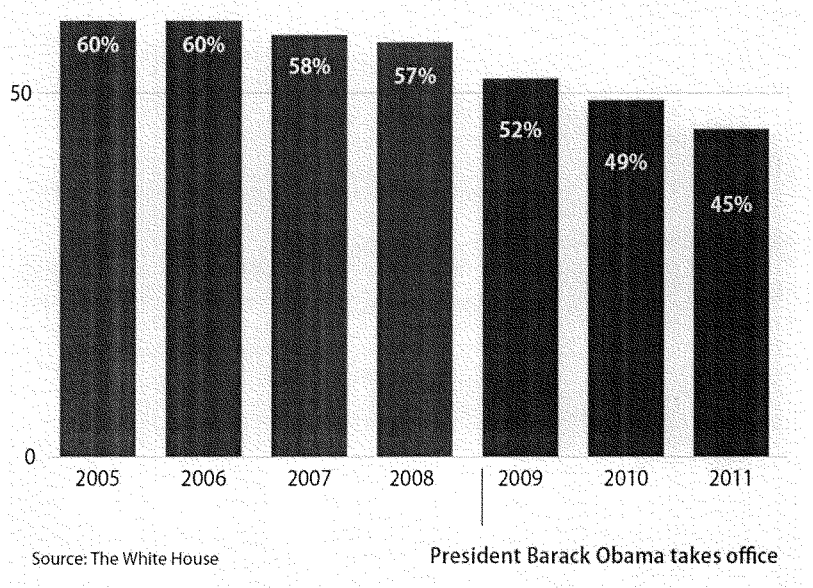
United States producing more oil

Some people contend that the United States is experiencing high oil and gasoline prices because we do not produce enough oil. This is misguided. The United States is producing significantly more oil than in recent years. In 2010 the United States produced a majority of its oil for the first time since the Clinton administration. In 2011 the United States produced the most crude oil since 2003, growing by 110,000 barrels per day compared to 2010—a 2 percent rise in a single year.

FIGURE 7

U.S. dependence on foreign oil declining

Net imports as a share of domestic consumption



Source: The White House

The amount of oil drilling rigs has dramatically increased since early 2009. An analysis by my CAP colleague Michael Conathan, Director of Ocean Policy, found that:

> When President Obama took office in 2009, there were fewer than 400 drilling rigs operating in the United States, a number that dwindled to fewer than 200 by April 2009.
>
> Since then, even as his administration conducted a wholesale review of drilling regulations in the aftermath of the worst offshore oil spill in the nation's history—the BP Deepwater Horizon oil catastrophe in the Gulf of Mexico—the number of oil rigs operating in the United States has quadrupled.

The *Houston Chronicle* reported that, "including those in natural gas fields, the United States now has more rigs at work than the entire rest of the world."

This increase in production under President Obama also created an additional 75,000 jobs in oil and gas production, according to Bureau of Labor Statistics data.

Additionally, EIA predicts that U.S. oil production will further increase in the coming year. And this production should continue to rise in the coming years because the administration is permitting more offshore oil production. After the BP Deepwater Horizon oil disaster, the administration required offshore rigs to employ new safety measures on rigs drilling in the Gulf of Mexico. Since then:

> The administration has approved hundreds of permits for drilling in the Gulf of Mexico, including:
>
> - 308 permits for deep water drilling activities for 94 unique wells in the Gulf of Mexico and;
> - 113 permits for shallow water wells in the Gulf of Mexico.
>
> [There is] now permitting at levels seen before the Deepwater Horizon oil spill, all while meeting these important new standards.

As offshore oil and gas production expands, it is imperative that Congress increase the $75 million liability cap for future offshore oil spills, blowouts and disasters. This is about five hours of the big five companies' 2011 profits. The damages from the BP Deepwater Horizon disaster will cost at least $40 billion for cleanup and to compensate people and businesses for economic damages to Gulf Coast residents and businesses. The current liability cap is far too tiny should a similar disaster occur, even with the implementation of the new rig safety standards. Companies that experience an oil spill or worse should be liable for all damages. This liability responsibility provision was included in the Consolidated Land Energy and Aquatic Resources (CLEAR) Act, H.R. 3534, which passed the House in 2010.

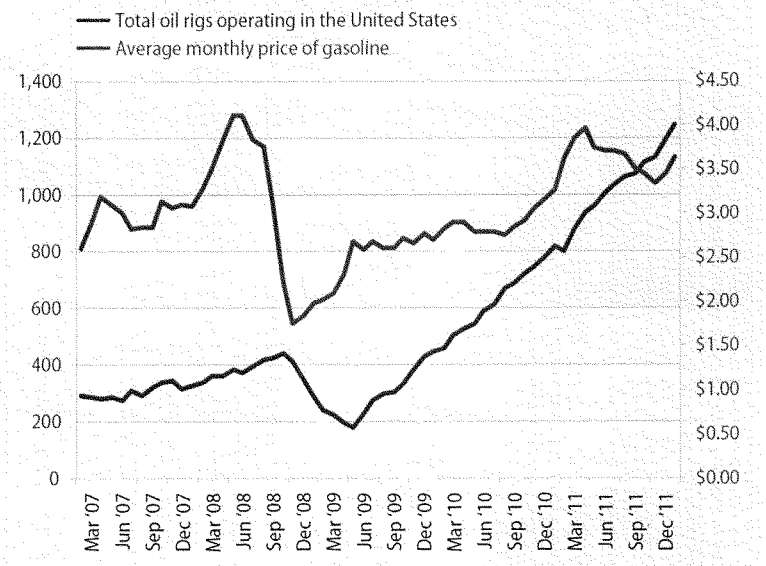
No federal policy changes are necessary to produce even more American oil. Three-quarters of the offshore oil in the continental United States is already open to production. Yet in March 2011 the Department of the Interior released a report revealing that two-thirds of oil-and-gas companies' existing offshore leases and more than half of their onshore leases are not under production.

The significant increase in oil production, however, has not lowered gasoline prices.

FIGURE 8

Increased oil production hasn't lowered gas prices

Number of oil rigs compared to the price of gasoline, March 2007 to February 2012



Source: For gas price data, see: "U.S. All Grades All Formulations Retail Gasoline Prices (Dollars per Gallon)," available at http://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=pet&s=emm_epm0_pte_nus_dpg&f=m. For rig data, see: "Baker Hughes Incorporated - Overview & FAQ," available at http://investor.shareholder.com/bhi/rig_counts/rc_index.cfm.

United States using less oil

In addition to producing more oil, the United States is using less oil. In 2011 the United States consumed an average of 18.8 million barrels per day. This is the second-lowest consumption level since 1997. In the month ending on February 3, 2012, we registered the lowest average gasoline consumption in 11 years—since February 2001. This gasoline consumption is considerably lower than the period from May 2008 through July 2008, when gasoline prices rose to a record nationwide average of $4.11 per gallon.

Seventy percent of all U.S. oil use is for transportation. Lower oil consumption is due in part to the first improvement in vehicle fuel economy standards in more than two decades, put in place by President Obama in 2009. A January 2012 study from the University of Michigan

Transportation Research Institute found that the "fuel economy of new vehicles continues to rise." Specifically:

> The average fuel economy of current model year vehicles is 14 percent higher than just four years ago.
>
> For all 2012 light-duty vehicles (cars, pickup trucks, minivans, vans and SUVs) offered for sale, average mpg is 21.5, compared to 18.9 mpg for model year 2008 vehicles. The averages were 21.2 for 2011, 20.7 for 2010 and 19 for 2009.

Model year 2011 cars go 7 percent farther on a gallon of gas compared to those made in 2008. And these savings will grow through 2016, when the average car will meet a standard of 35.5 miles per gallon—a 30 percent improvement from the 2010 standard.

In 2011 the administration finalized the first-ever fuel economy standards for work trucks, buses, and other heavy vehicles beginning in 2014. The White House determined that these standards "will save American businesses who operate and own these commercial vehicles approximately $50 billion in fuel costs over the life of the program." The new standards will save more than 500 million barrels of oil, too.

Later this year the administration—with the support of the major auto manufacturers and the United Auto Workers union—plans to finalize fuel economy standards for passenger vehicles manufactured from 2017–2025. By 2025 cars and light trucks will go twice as far on a gallon of gas compared to 2010 vehicles. These standards will save more than 2 million barrels of oil per day. Drivers of model year 2025 passenger vehicles will save $8,200 in lower gasoline purchases over the life of their vehicle compared to 2010 vehicles.

EIA's latest projections found that the United States will import less oil thanks to the aforementioned oil production and greater vehicle efficiency—not including the proposed 2017–2025 fuel economy standards.

> U.S. dependence on imported petroleum liquids declines in the AEO2012 Reference case, primarily as a result of growth in domestic oil production by more than 1 million barrels per day by 2020; an increase in biofuels use to more than 1 million barrels per day crude oil equivalent by 2024; and modest growth in transportation sector demand through 2035.
>
> Proposed fuel economy standards covering vehicle model years 2017 through 2025 that are not included in the Reference case would further reduce projected liquids use and the need for liquids imports.

The rescue of General Motors and Chrysler, initiated by former President George W. Bush and completed by President Obama, saved 1 million jobs. In addition, the restructuring of these companies led them to develop and manufacture more fuel-efficient models attractive to drivers, particularly when gasoline prices are high. *The New York Times* reported that the auto companies continue to prosper despite high gasoline prices.

> "Our product portfolio now contains some of the most fuel-efficient vehicles in our company's history," Reid Bigland, the head of United States sales for Chrysler, said in a statement. "A few years ago, higher fuel prices were a major threat to our total vehicle sales, whereas today, those higher prices have become far less of an issue."

A March 5 *New York Times* editorial reiterated that finding by noting that, "Two byproducts of the automobile bailout were the carmakers' acceptance of sharply improved fuel economy and a new commitment to building cars that can meet those standards."

This is an important contrast to 2008 when record-high gasoline prices contributed to a decline in auto sales. President Obama noted this difference last week. He said that General Motors and Chrysler are:

> Not just building cars again—they're building better cars. Thanks to new fuel efficiency standards we put in place, they're building cars that will average nearly 55 miles per gallon by the middle of the next decade. That's almost double what they get today. That means folks will be able to fill up every two weeks instead of every week, saving the typical family more than $8,000 at the pump over time. That's a big deal, especially as families are yet again feeling the pinch from rising gas prices.

Immediate relief: Sell a small amount of oil from the Strategic Petroleum Reserve

There are very few policy measures that can rapidly reduce oil and gasoline prices, but selling oil from the Strategic Petroleum Reserve to oil companies can help, particularly if coordinated with the sale of some reserves from other nations. The reserve was created in 1975 as a hedge against serious oil supply disruptions such as the Arab oil embargo of 1973–1974. It has a capacity of 727 million barrels of oil and is currently 96 percent full with 696 million barrels.

Presidents have the authority to sell reserve oil under the following circumstances described in the Energy Policy and Conservation Act:

> Drawdown and sale of petroleum products from the Strategic Petroleum Reserve may not be made unless the President has found drawdown and sale are required by a severe energy supply interruption or by obligations of the United States under the international energy program.
>
> > (2) For purposes of this section, in addition to the circumstances set forth in section 3 (8), a severe energy supply interruption shall be deemed to exist if the President determines that -
> >
> > > (A) an emergency situation exists and there is a significant reduction in supply which is of significant scope and duration;

(B) a severe increase in the price of petroleum products has resulted from such emergency situation; and

(C) such price increase is likely to cause a major adverse impact on the national economy.

There have been reserve oil sales under every president since 1991:

- President George H.W. Bush, along with some of our allies, sold reserve oil before the first Iraq war in anticipation of supply disruptions that did not materialize.
- The Republican Congress mandated two sales of reserve oil in 1996 to reduce the federal budget deficit.
- President George W. Bush sold oil in 2005 after Hurricanes Katrina and Rita disrupted production in the Gulf of Mexico.
- Last year President Obama sold 30 million barrels of reserve oil to offset the disruption of Libyan oil production during its civil war. Our partners in International Energy Agency, or IEA, nations sold 30 million barrels of their reserve oil, as well. (The IEA is an intergovernmental organization dedicated to responding to physical disruptions in the supply of oil, as well as serving as an information source on statistics about the international oil market and other energy sectors.)

Multinational reserve oil sales reduce oil and gasoline prices. (see chart below) For instance, last year the administration announced its sale of SPR oil on June 23 with completion on September 30. The IEA sale occurred during this time too. From the time of the announcement to the time of final sale, the price of WTI crude oil dropped by 17 percent, while the price of gasoline fell by 6 percent. Such a decline would reduce $4 per gallon gasoline to $3.76 per gallon.

FIGURE 9

Getting some relief at the pump

Strategic Petroleum Reserve oil sales' effects on gasoline prices

President	SPR oil sale announcement	Percent SPR filled	Percent change in oil price	Percent change in gasoline price
George H. W. Bush	January 1991	81%	-18%	-11.7%
Bill Clinton	May 1996	79%	-10%	-5.4%
Bill Clinton	October 1996	78%	-0.5%	+1.0%
George W. Bush	September 2005	94%	-16%	-19.2%
Barack Obama	June 2011	100%	-17%	-5.9%

* Prices in weekly U.S. regular all formulations retail gasoline prices (dollars per gallon)

Sources: U.S. Department of Energy, "Releasing Crude Oil From the Strategic Petroleum Reserve," available at http://fossil.energy.gov/programs/reserves/spr/spr-drawdown.html.; U.S. Energy Information Administration, "Weekly U.S. Regular All Formulations Retail Gasoline Prices (Dollars per Gallon)," available at http://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=EMM_EPMR_PTE_NUS_DPG&f=W.

There is also a legitimate concern about adequate oil reserves in case of a severe Iranian supply disruption, but we have ample supplies in the SPR to withstand it. Iran exports 2.2 million barrels of oil per day worldwide, and none of it comes to the United States. The United States could replace these Iranian exports to other nations for 60 days, and our reserves would still be 80 percent full. And after completely offsetting a 180-day disruption in Iranian oil supplies, the SPR would still be 40 percent full.

Iran has also threatened to cut off the Strait of Hormuz through which 17 million barrels of oil travel every day. This is about one-fifth of worldwide consumption. There is enough oil in the SPR that the United States could replace this oil for three weeks, and its reserves would still be half full. The bigger challenge in that scenario is that the SPR can release no more than 4.4 million barrels per day.

We must ensure that there is adequate reserve oil in case of a severe supply disruption. Selling 30 million to 50 million barrels of oil to offset recent disruptions would still leave the reserve at least 90 percent full. And the Congressional Research Service cautioned that:

> Being too cautious about the use of the SPR may mean its full value is never utilized. Further, market participants, including oil exporting countries, may discount the possibility that the United States would use this policy tool.

Long-term relief: Modern fuel economy, alternative fuels, and transportation investments

Even as we produce more and use less oil at home, oil prices remain subject to the global market. The 2011 disruption in Libya's oil production sent prices climbing. This year, Iran's saber-rattling to use oil as a weapon to defend its nuclear program is roiling markets. This destructive price volatility will continue to harm our economy and Americans if we continue to depend on a product with few substitutes where we consume 20 percent of the annual supply but only 2 percent of its resources. The ultimate path to long-term relief is to dramatically reduce our reliance on oil.

The United States must develop modern fuel economy standards to make cars go much farther on a gallon of gas. As noted above, the administration will soon finalize fuel economy standards for passenger vehicles manufactured from 2017–2025. If the standards are kept strong, they will save more than 2 million barrels of oil per day. Congress must resist pleadings of special interests to reduce or delay these standards since they will only increase gasoline consumption and prices.

In addition to much-improved vehicle fuel economy standards, we must begin the investment in cars and trucks powered by other fuels. Passenger vehicles could use readily available, increasingly clean electricity. Plug-in hybrids and all electric vehicles consume little or no gasoline. The Chevrolet Volt and Nissan Leaf are two early users of these fuels. During their first year of production, their combined sales were twice as large as the now familiar Toyota Prius hybrid during its first year.

As with cell phones, desktop computers, and other innovative new technologies, there will be bumps along the road to widespread commercialization. For instance, bad publicity for the Volt due to overstated concerns about the potential for fires has inhibited sales. Nonetheless, February 2012 sales were significantly higher than January sales. Despite GM's temporary halt in production to sell some existing inventory, it still plans to sell 45,000 Volts in 2012 – six times more than last year.

There is a long history of government support for the infrastructure essential to grow pioneering technologies, from FM radio to telephones. Electric vehicles, too, would benefit from such assistance with recharging infrastructure. The Electric Drive Vehicle Deployment Act of 2011, H.R.1685, sponsored by Rep. Judy Biggert (R-IL), would provide financial assistance to states for the deployment of electric vehicles.

Electricity is not a practical alternative to power heavy trucks. Many experts believe, however, that natural gas can power these vehicles. A Center for American Progress analysis determined that a transition to natural gas trucks and buses could reduce oil use by at least 1.2 million barrels per day. The NAT GAS Act, H.R.1380, sponsored by Rep. John Sullivan (R-OK) and 181 bipartisan cosponsors, would provide incentives to convert trucks to natural gas, as well as create a refueling infrastructure for natural gas vehicles. The Senate companion bill, S.1868, sponsored by Sens. Bob Menendez (D-NJ) and Richard Burr (R-NC), would fund these incentives with a small fee on the sale of liquefied or compressed natural gas.

Investments in buses, subways, and trains can also reduce our dependence on oil and create jobs. Public transportation saves the U.S. 900,000 automobile fill-ups per day, which equal 4.2 billion gallons of gasoline per year. Every $1 billion of investment in public transportation infrastructure supports 36,000 jobs in a variety of industries – construction, finance, insurance, real estate, retail and more.

Despite these overwhelming benefits, our public transportation infrastructure is woefully underfunded. A recent CAP report "Meeting the Infrastructure Imperative: An Affordable Plan to Put Americans Back to Work Rebuilding Our Nation's Infrastructure," by Donna Cooper found that an additional investment of $15.7 billion annually is needed to meet our most urgent public transportation infrastructure needs. This would increase oil savings and create jobs.

Unfortunately, the pending House transportation bill would undermine our existing transportation infrastructure. It would end the 30-year practice of allocating a small portion of the federal gas tax for transit funding. It would replace this predictable funding source with reliance on lower, speculative revenue from future oil drilling. The American Public Transit Association predicts that the House bill will

> "Lead to additional deferred maintenance, leading to less reliable service, fewer transit extensions, higher fares and potentially fewer riders."

This significant cut in transit ridership would force more people to drive, using more gasoline to travel. This additional demand would likely increase gasoline prices.

Lifting protection for special places won't reduce oil or gasoline prices

Some people are calling for more oil drilling in protected places to reduce gasoline prices, though they disingenuously neglect to mention that it takes seven years for new offshore oil drilling to produce any oil. And EIA found that opening up the currently protected Atlantic and Pacific Coasts won't have an impact on price. EIA also predicts that it will take 10 years to produce oil from the Arctic National Wildlife Refuge in Alaska.

Don't get me wrong. More American oil production benefits us in several ways. First, producing more and importing less would help our balance of trade. In 2010 it was estimated that oil imports were nearly half of our trade deficit. The nearly $1 billion sent overseas daily to purchase oil is money that will not recirculate here or create more economic growth.

Purchasing less foreign oil also enhances our national security. Canada and Mexico are our two largest importers. But a CAP analysis found one in five barrels of oil consumed in the United States in 2008 came from nations classified as "dangerous or unstable."

These are real economic and security benefits to our nation, and higher oil production should continue. At the same time, more U.S. production will not lower prices because oil prices are set on a worldwide market price, with the active participation of the Organization of Petroleum Exporting Countries, or OPEC, cartel. A significant production increase by one country could be offset by a reduction by another nation so that the price remains the same.

In fact, some oil-producing nations believe that some oil producers want to stabilize prices around $100 per barrel. In an interview with CNN, Saudi Arabian Oil Minister Ali al-Naimi said that, "Our wish and hope is we can stabilize this oil price and keep it at a level around $100" for the average barrel of crude oil. Saudi Arabia and other OPEC countries have the ability to raise or lower their production to accomplish this goal.

Ken Green, resident scholar with the conservative American Enterprise Institute, explained that crude oil is a global commodity whose price will be unaffected by new U.S. production. Last year Greenwire reported that:

> "The world price is the world price. Even if we were producing 100 percent of our oil," Green said, if prices increase because of a shortage in China or India, "our price would go up to the same thing...We probably couldn't produce enough to affect the world price of oil," he added. "People don't understand that."

Green also astutely predicted that some politicians would exploit higher oil prices to boost Big Oil's desire to drill on fragile lands and in coastal waters. "We're likely to see a replay of the McCain-Palin 'drill, baby, drill,' 'drill here, drill now.' It will probably be a cause célèbre for the party." His warning was prescient—those same cries are occurring this year as well.

Green is correct. Allowing production into protected, fragile places will not lower oil and gasoline prices today, tomorrow, next year, or the year after that.

State Department: Keystone pipeline won't increase production or lower prices

Other oil industry advocates claim that completing the Keystone XL pipeline from Alberta, Canada, to the Gulf of Mexico would both increase oil supplies and reduce prices. The State Department's analysis of the project found that neither assertion is accurate.

The State Department's final "Keystone XL Assessment" concluded that it would not increase oil supply or lower prices:

> WORLD and ETP studies indicate that building versus not building Keystone XL would not of itself have any significant impact on: U.S. total crude runs, total crude and product import levels or costs. (emphasis original)

The State Department analysis determined that the pipeline would only have a tiny impact on the price of crude and other products:

> Under the KXL scenario, delivered prices for [oil sands] ... into PADD3 Gulf Coast are lower than under the No KXL case and those for PADD2 [Midwest], higher. The effect is limited, no more than around $0.70/bbl.

The analysis acknowledges that the pipeline would actually raise gasoline prices in the Midwest since it would eliminate the current oil glut there that has kept prices lower. Bloomberg cautions that, "TransCanada Corp.'s Keystone XL oil pipeline ... risks raising prices as much as 20 cents a gallon in the Midwest, Great Plains and Rocky Mountains." At the same time, there may be a decrease in gasoline prices in the Gulf region because of the increase in oil supply there.

Time magazine's analysis concurred that Keystone would have almost no impact on gasoline prices. "Keystone would have little immediate [price] effect, especially since there's already sufficient pipeline infrastructure in place for the next few years."

Additionally, there are indications that a portion of the oil sands piped through Keystone to Gulf Coast refineries will be refined into products for export rather than kept here for American drivers. At a December 2, 2011, hearing before a subcommittee, Rep. Ed Markey (D-MA) asked the CEO of pipeline-owner TransCanada whether he would agree to keep all refined products from oil sands in the United States. He declined.

One way to ensure that Keystone adds a marginal amount of oil to U.S. supplies is to require that the oil and its refined products be sold here—not exported. On February 15 Rep. Markey offered an amendment to H.R. 3408 to "ensure that if the Keystone XL pipeline is built, the oil that it transports to the Gulf of Mexico and the fuels made from that oil remain in this country to benefit Americans." The amendment failed 173–254, which means that some of the oil sands will be exported.

Some advocates of building this pipeline claim that it would also help lower gasoline prices because this project is "shovel ready." This is also false. The Keystone pipeline isn't even map ready yet since its route through Nebraska has yet to be decided. And there has been no

assessment of the potential harm to adjacent air, water, and land from its construction and operation once it is sited.

In fact, there is a growing controversy over building the pipeline in places where the route is already mapped. The *Los Angeles Times* reported on the conflict between landowners and TransCanada:

> Canadian company that wants to build the 1,660-mile structure [is] going to court to force the cooperation of landowners who don't want it crossing their land.
>
> The issue has brought conservative tea party groups out rallying alongside environmentalists opposed to tar sands oil production, united behind [Julia Trigg] Crawford's attempt to keep the pipeline from crossing her 600-acre farm in the town of Direct, near Paris, where she fears it could contaminate the creek that irrigates her fields.

This controversy suggests that construction is not "shovel ready" outside of Nebraska either.

The bottom line is that the State Department and other independent analyses determined that the Keystone XL pipeline won't increase U.S. oil supplies, reduce gasoline prices, or even transport any oil anytime soon.

Other dubious proposals won't reduce gasoline prices but will harm public

There are several other perennial proposals made by special interests that they claim would reduce oil and gasoline prices but in reality would only harm the economy or public health. One dubious idea is to suspend the 18-cents-per-gallon federal gasoline tax in an effort to lower prices. There is no guarantee, however, that Big Oil companies would pass these savings along to drivers. The Congressional Research Service warned that:

> The market response to a cut in the excise tax would be a tendency to reduce consumer prices by an amount less than or equal to the tax cut. Issues related to market structure and economic conditions may result in refiners not passing on the full benefit of the tax reduction to consumers.

More significantly, suspending the gas tax would deprive states of funds to pay for badly needed highway repair and transit projects. The gasoline tax is already too low to support our transit needs. A recent CAP report, "Meeting the Infrastructure Imperative," found that an additional $63 billion per year over the next decade is necessary to repair our roads, bridges, rail, and transit systems. Eliminating these infrastructure funds would also cost jobs when our economy is still recovering.

Another regular proposal to lower gasoline prices is to waive the summer pollution reduction requirements for gasoline in metropolitan areas with severe smog problems. These standards reduce some of the smog forming components in gasoline. Abandoning them might reduce gasoline costs by only a few cents per gallon but would increase smog that harms children,

seniors, and others. In addition to human suffering, such a step would have real economic costs due to additional health care expenditures and lost productivity.

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[1] Congressional Research Service, "Rising Gasoline Prices 2012" (2012).

[2] Richard Caperton and Jackie Weidman at CAP ran a regression analysis with the nominal values for average quarterly gas prices (the independent variable) and quarterly oil company profits (the dependent variable) from 2008 through 2011. This showed a coefficient of 20.3, meaning that when average gas prices change by $1 over a quarter, big five profits change by $20 billion. The p-value for this analysis is 0.000117, which indicates a statistically significant positive relationship between the two values. The data and calculations are available upon request.

[3] For more information about each of these provisions, see: Seth Hanlon, "Big Oil's Misbegotten Tax Gusher: Why They Don't Need $70 Billion from Taxpayers Amid Record Profits" (Washington: Center for American Progress, 2011), available at http://www.americanprogress.org/issues/2011/05/big_oil_tax_breaks.html

[4] P. 30

Mr. WHITFIELD. Thank you. Mr. Breen, you are recognized for 5 minutes.

STATEMENT OF MICHAEL BREEN

Mr. BREEN. Thank you, Chairman Whitfield, Ranking Member Rush, members of the committee. Ladies and gentlemen, I am honored to appear before you today to discuss this issue.

I come before you first and foremost as fellow citizen, one deeply concerned about the future prosperity and security of this great Nation. I serve as the Vice President of the Truman National Security Project, a leadership institute dedicated to forging strong, smart, and principled national security policy for America. As a former Army Captain and an Iraq and Afghanistan combat veteran, I am also proud to be one of the leaders of Operation Free, a non-partisan nationwide community of veterans dedicated to the common belief that our national addiction to oil poses a clear national security threat to the United States.

The veterans of Operation Free have seen the consequences of our dependence on oil first-hand on the battlefield. As a young lieutenant on my first combat tour, I served on an isolated fighting camp in an area south of Baghdad known as the "Triangle of Death." My unit was entirely dependent on daily fuel convoys to power our generators and fuel our vehicles. Recognizing this, Iraqi insurgents consistently ambushed the convoys while my infantry company fought to protect them, leading to almost-daily firefights we jokingly called "fighting for our supper." The insurgents had recognized a crucial weakness, one that our Nation shares, one that Osama bin Laden once referred to as America's "Achilles heel": our dependence on oil as a single source of fuel.

America sends over $1 billion per day overseas for oil. It should not be a surprise, then, that oil is the single largest contributor to our foreign debt, outpacing even our trade imbalance with China. Worse, far too many of those dollars wind up in the hands of regimes that wish us harm.

For every $5 rise in the price of a barrel of crude oil, Putin's Russia receives more than $18 billion annually, Chavez's Venezuela an additional $4.9 billion annually, and Iran an additional $7.9 billion annually.

Today, our Nation remains locked in a high-stakes confrontation with a volatile Iran. Iran's pursuit of a nuclear weapons capability and support for terrorism are among our gravest national security challenges. As we grapple with those challenges, we must not forget that neither nuclear weapons nor support for terrorism comes free. According to the CIA, over 50 percent, over half of Iran's entire national budget comes from the oil sector. That is enough to pay for their nuclear program, support for terrorism, and aid to despots and dictators like Syria's Assad.

But Iran is not America's only oil-funded security threat. Even Afghanistan's Taliban benefits from ever-increasing oil prices. According to former Special Envoy Richard Holbrooke, the Taliban's major source of funding is private donations from individuals in oil-rich Iran, Saudi Arabia and other Persian Gulf states. Opium is number two.

Congress must act to meet this danger in the only way that makes sense, by developing a broad set of alternatives to oil. As has been said frequently, there is no single solution, no silver bullet, that can break oil's grip on our national fortunes, but fortunately, Congress has silver buckshot in its arsenal. We can and must aggressively pursue policies that open a broad range of alternatives to oil.

This morning in North Carolina, President Obama is announcing a "Race to the Top" challenge to encourage communities across America to adopt advanced vehicles, building infrastructure, removing regulatory barriers, and creating local incentives. What is most exciting about this proposal is that it embraces choice. Communities themselves are free to decide if electric vehicles, natural gas, or alternative fuels are the best for them. The administration has also proposed improvements to the current tax credit for electric vehicles, tax incentives for alternative fuel commercial trucks, and a research and development grand challenge designed to bring down the cost of electric vehicles. These proposals may not be perfect, but they are certainly steps in the right direction, and I hope that this Congress will work with the administration to improve and expand upon them.

My earliest military training taught me to anticipate threats and take action to defeat them. Our military leaders understand this when it comes to the cost of oil, and our sole dependence on this single source of fuel. This is a cost that extends beyond the gas pump. It extends onto the battlefield.

So I respectfully conclude with a simple request: lead us. Lead us in building an alternative energy economy that can break our dependence on oil, and finally put Americans in control of our own energy future.

Thank you.

[The prepared statement of Mr. Breen follows:]

Testimony of Michael Breen, Vice-President, Truman National Security Project

March 7th, 2012

Chairman Whitfield, Ranking Member Rush, members of the Committee, Ladies and Gentlemen, I am deeply honored to have the opportunity to appear before this distinguished panel today to discuss the critically important issue of our national dependence on oil as a single source of fuel, and the impact of that dependence on our national security.

I come before you first and foremost as a fellow citizen, deeply concerned about the future prosperity and security of our great nation. I serve as the Vice President of the Truman National Security Project, a leadership institute dedicated to forging strong, smart and principled national security policy for America. As a former Army Captain and an Iraq & Afghanistan combat veteran, I am also proud to be one of the leaders of Operation Free, a non-partisan nationwide coalition of patriotic veterans who stand together in the common belief that our national addiction to oil poses a clear national security threat to the United States.

The veterans of Operation Free have seen the consequences of our dependence on oil as a single source of energy first-hand, on the battlefields of Afghanistan and Iraq. As a young Lieutenant on my first combat tour, in Iraq, I served on a isolated fighting camp south of Baghdad in an area known as the "Triangle of Death." My unit was entirely dependent on a daily fuel convoys to power our generators and fuel our vehicles. Recognizing this, Iraqi insurgents consistently ambushed the convoys while my infantry company fought to protect them – leading to almost-daily firefights we jokingly called "fighting for our supper." The insurgents had recognized a crucial weakness, one that Osama bin Laden referred to as America's "Achilles heel": our dependence on oil as a single source of fuel.

We pay a high price for that single source dependence, in both treasure and blood. A $10 increase in the price of a barrel of oil costs the Department of Defense an estimated $1.3 billion –

almost equal to the entire procurement budget for the Marine Corps.[i] The fully burdened cost of fuel is $40 a gallon in parts of Afghanistan. Meanwhile, half of the convoys that have braved the harrowing highways of Baghdad and the narrow mountain passes of Afghanistan carry the oil our force cannot fight without. And one in twenty-four of those convoys ends in an American casualty.[ii]

For our troops in harm's way, the reality of oil dependence is stark. Yet we confront an equally stark reality as a nation. Over 95% of the American transportation sector runs on oil.[iii] Our economy is overwhelmingly dependent on this single, globally-traded strategic commodity. Unfortunately, the price of that commodity is almost certain to continue to rise by fits and starts, draining our economy and benefiting our enemies. Reliance on this single source of fuel is a security risk we can no longer tolerate.

U.S. demand for crude oil and its derived products has held roughly flat for years now. Meanwhile, domestic production has been robust, increasing in the last several years. Yet, despite stagnant U.S. demand and increasing U.S. production, relentlessly increasing global demand continues to push the price of oil ever higher, driving a massive transfer of our national wealth to other nations.

America sends over $1 billion per day overseas for oil.[iv] It should not be a surprise, then, that oil is the single largest contributor to our foreign debt, outpacing even our trade deficit with China. Worse, far too many of those dollars wind up in the hands of regimes that wish us harm.

A Truman Project colleague conducted an analysis on the impact that increases to crude oil prices have on the gross revenue streams of certain nations. This research concluded that for every $5 rise in the price of a barrel of crude oil, Putin's Russia receives more than $18 billion annually, Chavez's Venezuela an additional $4.9 billion annually, and Ahmadinejad's Iran an additional $7.9 billion annually. I do not believe that anyone in this room today would support an energy policy that transfers our national wealth to such regimes.

Today, our nation remains locked in a high-stakes confrontation with a volatile Iran. Iran's pursuit of a nuclear weapons capability and support for terrorism are among our gravest national security challenges. As we grapple with those challenges, we must not forget that neither terrorism nor nuclear technology is free. According to the CIA, over 50% of Iran's entire national budget comes from the oil sector.[v] That's enough to pay for their nuclear program, support terrorism, and back dictators like Syria's Assad.

Iran is not America's only oil-funded security threat. Even Afghanistan's Taliban benefits from ever-increasing oil prices. According to former Special Envoy Richard Holbrooke, the Taliban's largest source of funding is not drug trafficking, as is commonly believed.[vi] Rather, private foreign donations from individuals in oil-rich Iran, Saudi Arabia and other Persian Gulf states keep the insurgency running.

Our military leaders have not been idle in the face of this challenge. They are acting decisively to increase efficiency and pursue alternatives that break our force's singular dependence on oil. The U.S. Navy is committed to reducing petroleum use by 50% by 2015, with the goal of 40% of total energy consumption from alternative sources by 2020. In 2010, the Navy conducted the first flight test of the "Green Hornet" – an F/A-18 strike fighter powered by a 50% biofuel blend derived from the camelina plant.

The Navy's efforts demonstrate that our military leaders understand the critical danger we face. They are acting to meet that danger, in the only way that makes sense: by developing alternatives to oil.

Congress must also act to ensure that Americans have alternatives to oil. There is no single solution, no silver bullet, that can break oil's grip on our national fortunes. Fortunately, Congress has silver buckshot in its arsenal. At a minimum, we need robust research and development into a broad range of alternative fuels and vehicle technologies, support for communities across America as they

transition their infrastructure to support alternative vehicles, and tax incentives for families and small businesses that purchase those alternative vehicles.

My earliest military training taught me to anticipate threats and take action to defeat them. Our military leaders understand this when it comes to the cost of oil – a cost that extends beyond the gas pump and onto the battlefield. Congress must take equally decisive action.

I respectfully conclude with a simple request: lead us in building an alternative energy economy that can break our dependence on oil, ensure our future prosperity and security, and finally put Americans in control of our own energy future.

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[i] CNA Report on "Powering Amrica's Defense: Energy and the Risks to National Security" (May 2009) http://www.cna.org/documents/PoweringAmericasDefense.pdf

[ii] "Casualty Costs of Fuel and Water Resupply Convoys in Afghanistan and Iraq." Army-Technology.com, February 26th, 2010. http://www.army-technology.com/features/feature77200/

[iii] "Petroleum & Other Liquids." U.S. Energy Information Administration. http://www.eia.gov/pub/oil_gas/petroleum/analysis_publications/oil_market_basics/demand_text.htm

[iv] Powers, Jonathan. "Oil Addiction: Fueling Our Enemies." Truman National Security Project, February 17th, 2010. http://www.trumanproject.org/files/papers/Oil_Addiction_-_Fueling_Our_Enemies_FINAL.pdf

[v] CIA World Factbook. "Iran." CIA, February 21st, 2012. https://www.cia.gov/library/publications/the-world-factbook/geos/ir.html

[vi] Schmitt, Eric. "Many Sources Feed Taliban's War Chest." New York Times, October 18th, 2009. http://www.nytimes.com/2009/10/19/world/asia/19taliban.html

Mr. WHITFIELD. Thank you. Mr. Eichberger, you are recognized for a 5-minute opening statement.

STATEMENT OF JOHN EICHBERGER

Mr. EICHBERGER. Thank you, Mr. Chairman. My name is John Eichberger. I am with the National Association of Convenience Stores.

Convenience stores sell about 89 percent of the gasoline at retail in the country through 121,000 stores. Of those 121,000 stores that sell fuel, 58 percent are single store companies, true mom and pops. What I want to talk about a little bit is how retailers set prices, and basically I describe it as it is truly a street fight. Retailers look at competition, they look at their cost. We post our prices on 20-foot signs. Customers can shop for the best value driving 45 miles an hour without even stopping. We did a survey earlier this year that 40 percent of consumers will drive 5 minutes out of their way to save as little as 3 cents a gallon. That means that retailers have to figure out the best price from a competitive standpoint to sell fuel.

In our industry, 2/3 of our overall sales are fuel related. Three-quarters of our profit, however, comes inside the store, so we need to set prices that attract customers to our facilities, and then figure out ways to get them inside the store to sell them items where we make more money, such as coffee and sandwiches.

We also have to pay close attention to cost, however. In 2011, we calculated the average cost to sell a gallon of gasoline is about 17 cents. That means we need to mark up our fuel about 17 cents just to break even. Unfortunately in 2011, the average margin was actually 18.2. The average retailer is making 1.2 cents per gallon in 2011. But even that is difficult sometimes because the cost of wholesale fuel changes rapidly, several times in one day. Because each retailer incurs different costs, if a retailer gets a 10-cent increase today, they might not be able to pass that along to their customers immediately because the competition won't allow them to, so they eat some of that increase and they lose margin going up, and they try to recover when the prices come back down, but the pricing decisions are constant among all retailers at the same time. They are fighting for that customer every single day.

Our wholesale prices are heavily dependent on crude oil. Both products are traded on the open market, and as has been mentioned many times today, speculative investment into these commodities markets has an inflationary influence on the price that we pay. Any type of indication of what future supply and demand may have can change the way traders bid the price up or down, and that affects the price consumers pay at the pump. Right now we know oil is making about 75 to 80 percent of the retail price of gasoline, and that needs to be addressed.

So a couple things that I think we can do to help address the issue, unfortunately, retailers don't have a whole lot of flexibility. Our margin right now this year so far is averaging 3.6 percent. There is not a whole lot of room to maneuver to give customers a better deal at the pump. They are trying, though. A lot of customers—a lot of retailers are offering discounts to customers to en-

tice them to come to their stores. Our goal is to give them the best value at the pump so they will buy more products inside the store.

But there are some things I think Congress can do, and Mr. Waxman mentioned in my written statement, I do believe that if we increase international supplies of oil, domestically and internationally, that will have an effect on traders and hopefully will bring prices down on the market to benefit consumers. I also think we need to take a careful look at our regulatory structure. Whether a regulation being proposed and considered is beneficial to the environment, to consumers or not, it is going to have a cost and we need to recognize those costs will be passed on to customers. So as we are thinking about regulatory structures, let us think about how we can accomplish our objectives in the least costly manner possible at the benefit of our customers.

And finally, I think we need to really think about harmonizing our fuel regulations. We have great objectives. Let us reduce our dependence on oil, improve efficiency, become more energy secure, benefit our customers with lower prices. Unfortunately, we don't always take our regulatory proposals and balance them and coordinate them. For example, the current proposal to increase CAFE standards takes about 54.5 miles per gallon. A great objective, however, I took a look at EIA's projections on a more modest CAFE proposal. If you compare that to the Renewable Fuel Standard, in 2022, we are supposed to bring 36 billion gallons of renewable fuels to the market. If we have a more modest CAFE proposal, to make that happen we have to include 37 percent of every gallon of gasoline is going to have to be renewable. Unfortunately, my stores are not capable of selling that type of product. If we have to replace all of our tanks and dispensers, the cost is going to be about $22 billion. Not to mention EIA projects that the only vehicles right now that can run on that fuel are flex fuel. In 2022, they are only going to be 15 percent of the market. We have two policies that from a logical perspective may make sense, but together they can't work together. We need to really think about a comprehensive coordinated fuels policy. How do we obtain our objectives in a way that makes sense? Let us get these projects to market, let us reduce our dependence, improve our efficiency, help the customer at the pump, and let us do it in a smart way. That is going to take a fresh approach to regulatory standards and objectives.

I thank you very much for your time.

[The prepared statement of Mr. Eichberger follows:]

NACS

TESTIMONY OF

JOHN EICHBERGER
NATIONAL ASSOCIATION OF CONVENIENCE STORES (NACS)

MARCH 7, 2012

TO

HOUSE ENERGY AND COMMERCE
SUBCOMMITTEE ON ENERGY AND POWER

HEARING:

"THE AMERICAN ENERGY INITIATIVE: A FOCUS ON RISING GAS PRICES"

The Association for Convenience & Fuel Retailing
1600 Duke Street • Alexandria, VA 22314-3436 • (703) 684-3600 • FAX (703) 836-4564 • www.nacsonline.com

INTRODUCTION

Chairman Whitfield, Ranking Member Rush, members of the Subcommittee, thank you for the opportunity to speak with you today. My name is John Eichberger and I am Vice President of Government Relations for the National Association of Convenience Stores (NACS).

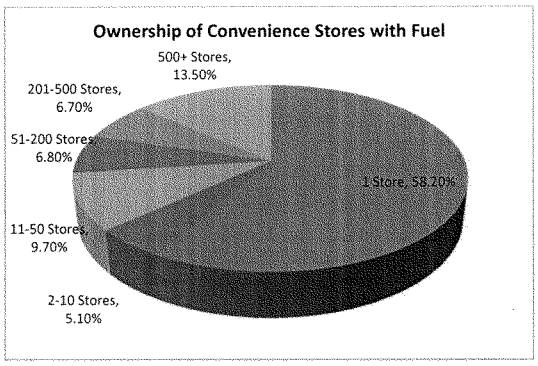
NACS is an international trade association representing the convenience and fuel retailing industry. Our membership consists of nearly 2,200 retail member companies and nearly 1,800 supplier companies. In 2010, the industry operated 148,000 stores in the United States, generated $575.6 billion in sales (of which $385.1 billion was in motor fuels), sold 80% of the fuel consumed in the country and employed 1.6 million workers.

I appreciate the opportunity to speak with you about retail gasoline prices. Our members, as the last link in a very long supply chain, have a better understanding of consumer frustration than others in the fuel system. And they often experience similar frustrations as they attempt to provide value to their customers while generating a profit for their business. My testimony today will address how retailers operate in a volatile fuels market and what can be done to stabilize conditions for consumers.

COMPOSITION OF THE RETAIL MARKET

The retail fuels market is diverse and ever-changing. At the end of 2011 there were 120,950 convenience stores that sold motor fuels in the United States. These stores sell approximately 80% of the gasoline consumed in the nation every year. The remaining 20% of the fuel is sold through hypermarket stores like supermarkets, club stores and warehouse stores, traditional service stations, fleet operations and marinas. All totalled, there are approximately 160,000 fuel retailers operating the United States.

Of the convenience stores that sell fuel, 58.2% are owned and operated by companies that have just one store. And although 32% of convenience fuel outlets sell the fuel brand of an integrated oil company, major oil companies own and operate fewer than 1% of the facilities. In fact, ExxonMobil, ConocoPhillips, BP and Shell have either sold or are in the process of selling all of the retail facilities they own. The remaining branded locations are simply reflective of supply contracts in which the independent retailers sell fuel under the brand of their refiner-supplier. In general, the retail fuels market is independent and entrepreneurial.



RETAIL SALES MIX – FUEL DRIVES CONSUMERS

In 2010, the convenience and fuel retailing industry generated $575.6 billion in sales – 1 of every $24 spent in the United States. Of that $575.6 billion, motor fuels were responsible for 66.9%. But while fuel sales drive the overall performance of the industry, they do not drive a retailer's ability to make a fair profit. That same year, the industry reported $6.5 billion in pre-tax profits of which only 26.4% was attributable to fuel sales.

In general, the industry seeks to leverage fuel sales to drive customers inside the store where profit margins are much healthier. This means that the competition for customers has intensified and over the years, especially since 2008, consumer price sensitivity has driven retail profitability lower.

In a 2012 survey of consumers, NACS found that 63% of customers decide where to buy gasoline based upon price. Further, consumers report that they will go out of their way to save pennies per gallon.

NACS found that 40% of consumers would drive 5 minutes out of their way to save as little as 3 cents per gallon. To put that into perspective, assume the customer is driving 45 miles per hour and their vehicle gets 30 miles per gallon. A 10 minute round trip would take the consumer 7.5 miles and consume ¼ gallon of gasoline. At $3.50 per gallon, this detour would cost the consumer 87 cents. The average fill-up is 10 gallons, which means the total savings at the pump would be 30 cents. The consumer spent 57 cents more in order to make this purchase.

While this behavior does not make rational economic sense, it provides the consumer with a sense of accomplishment to be able to say they saved 3 cents per gallon. Nobody likes to buy fuel, but it is a necessity for most. And when the changing price of this essential commodity is in the customers' face every single day on giant signs at the side of almost every road, it is understandable they would be very concerned about the price they are paying.

Retailers understand this sensitivity and are wary of pricing themselves out of the market. If 3 cents per gallon may cost them 40% of their customers, retailers will be reluctant to set a price at that level.

How Retailers Determine Price

Facing this type of consumer behavior, the retailer is in a very difficult situation – how to set the optimum price to attract as many consumers as possible to lift sales inside the store while turning at least a modest profit at the pump. They also have to understand that 73% of consumers buy fuel and leave without ever entering the store. This contributes to a very delicate decision making process, which can be described in two steps.

Step 1: Evaluate the Competition

To determine the best retail price, a retailer must survey the competition. The retailer wants to set a price that will provide the greatest benefit to his store. Looking at historic data, or perhaps even using a price optimization software program, the retailer will be able to determine what price differential compared to the competition has generated the greatest balance between inside sales, fuel gallons sold and fuel margins. The retailer may determine that being one penny higher than Competitor A, two pennies lower than Competitor B and the same price as Competitor C provides the best mix for his location. Once that optimum price is determined, the retailer must consider if he can afford to sell fuel at that price. Keep in mind that this calculation is being done by multiple players within the same market who are all vying to capture the same price-sensitive consumer.

Step 2: Evaluate Costs

A retailer must set a price that allows him to cover the costs associated with selling his fuel and, hopefully, generate a fair profit.

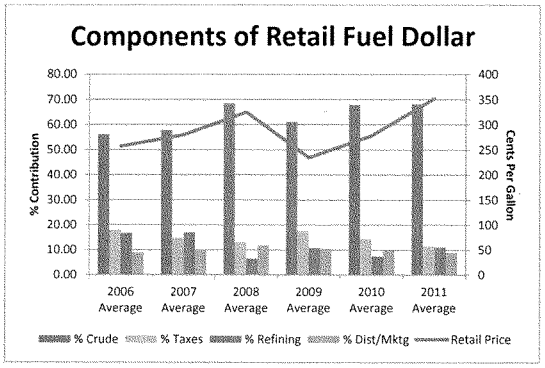
To better explain this function of the market, NACS evaluated the costs associated with operating a retail fuel business and allocated these costs on a per gallon equivalence. In 2011, the average retail price was $3.50 and it cost on average approximately 17 cents to sell a single gallon of gasoline. On average, it costs approximately 6 cents per gallon for direct store operating expenses, 3 cents per gallon for facility maintenance and operations, and 2 cents per gallon for additional costs such as inventory shrink, theft and overall business operations. In addition, every fuel transaction paid for with a credit or debit card incurs additional expense. When averaging these transactions over all fuel transactions, including those paid for with cash, the average per gallon card expense is approximately 6 cents.

In 2011, because it cost the retailer on average approximately 17 cents to sell a single gallon of fuel, the retailer needs to charge at least 17 cents per gallon more than what he paid for the fuel. (This 17 cents is also called the fuel break-even number. Over the past several years, it has varied between 13 – 17 cents per gallon depending on the price of fuel.) This differential between what he paid for the fuel and what he sold the fuel, not considering other costs, is called the gross margin. What money is left after paying the 17 cents in expenses is known as the net margin or pre-tax profit.

However, selling fuel at a high enough price to cover costs and generate a profit is not always possible because the wholesale cost of gasoline can change several times in one day and not all retailers incur the same price change at the same time. So, when the optimum price to attract consumers is lower than the price necessary to break-even, the retailer must determine if the anticipated increase in sales inside the store will compensate for the potential loss at the pump.

COST OF FUEL

The primary factor influencing the cost of gasoline is crude oil. According to the U.S. Energy Information Administration (EIA), crude oil represented on average 68.2% of the retail price of gasoline in 2011. However, in December 2011 and January 2012, crude oil represented 80.0% and 75.5% of the retail price of gasoline, respectively. Over the years, crude oil has consistently been the dominant factor in the price of gasoline.



As crude oil prices move up and down, the wholesale price of gasoline moves with it. This wholesale price determines the cost of goods sold for gasoline retailers. In a perfect world, when wholesale prices change, retailers would adjust their prices to reflect the change. But this is not always possible.

Wholesale fuel prices, which are heavily dependent upon traders on the commodities exchanges, can change several times in one day and retailers are constantly trying to keep pace. The problem is that not all retailers receive deliveries at the same time, nor do they pay the same price at wholesale due to the structure and terms of their contracts. One retailer may incur a 10 cent increase on Monday while another may incur only a 5 cent increase on Tuesday – this changes each retailer's ability to set the most competitive price. Consequently, competitive pressures often prevent the retailer from immediately covering an increase in the cost of goods sold.

Another challenge facing retailers is ensuring the ability to pay for the next delivery of fuel. A typical fuel delivery is 8,000 gallons. At $3.00 per gallon, the retailer must be able to pay $24,000 for that inventory. Since most retailers are small operators, they often do not have the cash reserves to pay for this increase in inventory costs so they attempt to generate enough

revenue from current inventories to pay for the next delivery. In such situations, retailers will often attempt to incorporate into their prices "replacement costs," increasing retail prices in advance of a delivery in order to generate additional revenues to pay for the replacement gallons.

Because of these pressures, when wholesale fuel prices are increasing, it is a challenge for retailers to maintain sufficient markups to cover costs and generate a reasonable profit margin. Typically, during periods of increasing prices retailers operate at lower margins and may in fact lose money on the fuel they sell. However, when prices are declining retailers have an opportunity to recover their lost margins and improve their profitability.

Many observers argue that retailers are quick to increase their prices but slow to decrease their prices. To a degree, this is true. That is because once prices begin to decline retailers try to maintain their elevated street price as long as possible to recover the margins they lost on the way up. However, once one retailer decides he has recovered and wants to attract more customers he will drop his price and every competitor will race to follow him down. These competitive pressures and the volatility of the market make it impossible to evaluate the profitability of a retailer during any one point in time. Rather, it is necessary to observe the market over a period of time.

RETAIL PROFITABILITY

In observing retailer market conditions over the period of a year, it is possible to evaluate the average profitability of fuel retailers. The following table reports the annual average retail prices, the reported retail markup and the percent markup over the past several years. Remember, in 2011 it cost 17 cents to sell a gallon of fuel.

Historic Annual Market Performance (2006-2012)			
Year	**Average Retail Price**	**Average Reported Retail Gross Margin**	**Gross Margin as % of Retail Price**
2012	$3.46	12.6 cents	3.6%
2011	$3.51	18.2 cents	5.2%
2010	$2.77	16.6 cents	6.0%
2009	$2.33	13.0 cents	5.6%
2008	$3.24	18.0 cents	5.6%
2007	$2.79	13.8 cents	4.9%
2006	$2.57	13.8 cents	5.4%

Although the average retail price has changed considerably over the years, this table demonstrates that the cents per gallon gross margins have remained relatively stable. This has driven the percent margin lower over time, making it much more difficult for retailers to sell fuel for a profit.

The following table displays the average profitability available to retailers over the past year by listing the price, cost to sell fuel, average markup and the resulting retailer profit or loss:

Historic Quarterly Market Performance (2011–2012)						
Period	**Avg Retail Price**	**2011 Est. Fixed Expenses**	**Avg Card Costs**	**Avg Fuel Break-Even**	**Avg Gross Margin**	**Average Retailer Profit/Loss**
1Q2011	$3.25	$0.11	$0.055	$0.165	$0.143	(-$0.022)
2Q2011	$3.79	$0.11	$0.064	$0.174	$0.207	$0.033
3Q2011	$3.63	$0.11	$0.061	$0.171	$0.190	$0.019
4Q2011	$3.36	$0.11	$0.057	$0.167	$0.189	$0.022
J-F 2012	$3.46	$0.11	$0.059	$0.169	$0.126	(-$0.043)

RETAILERS STRIVE TO PROVIDE LOW COST OPTIONS TO CONSUMERS

Fuel retailing is a very competitive business. Retailers make decisions to maximize customer traffic, boost in-store sales and cover their costs at the pump. Competition for the price-sensitive consumer often results in declining or negative margins for retailers, until wholesale prices decline. At that point, competition often allows the retailer to recover the margins lost during the run-up in prices.

To help the consumer deal with fluctuating fuel prices, there is little retailers can do other than compete. The portion of the retail fuel dollar within the control of the retailer is limited, as evidenced by the gross margin presented in the above table. NACS has been working with the National Conference on Weights and Measures to reform regulations to ensure that retailers can continue to offer consumers discounts at the pump. And the 2012 NACS Consumer Fuels Report indicates that such discounts are valuable to consumers.

In fact, 57% of consumers said they would consider taking advantage of a discount offered if they paid with cash. Other discounts consumers would consider include a discount for paying with a debit card (41%), using a loyalty card (44%) and using a discount associated with a purchase from another store like a supermarket (49%).

And retailers have responded, with 48% of consumers reporting that a fuel discount is available at a store convenient to them. Of these customers, 84% have taken advantage of one of these discounts, with 33% having saved money by paying with cash, 7% paying with a debit card, 33% using a loyalty card, and 29% leveraging a discount from another store.

CONGRESS AND ADMINISTRATION CAN INFLUENCE RETAIL PRICES

Retailers are doing what they can to provide consumers the best value at the pump, but again their influence over the ultimate price is limited. The largest contributing factors to the retail price of gasoline are beyond the control of retailers. But there some things Congress and the Administration can do to influence these other factors:

Crude Oil: Because crude oil contributes more to the retail price of fuel than any other component, this is the area in which the greatest benefit can be derived. The United States has a variety of crude oil resources that are not yet contributing to the world market, including shale oil reserves, off-shore and Arctic Circle resources. In addition, improving access to Canadian crude oil products would help supplement overall supplies.

While it is not reasonable to believe that the United States can independently dominate the international crude oil supply situation, supplant the world's largest suppliers or offset increasing demand in the developing world, it is reasonable to believe that expanded domestic production can help calm the markets. There is a substantial amount of speculative investment contributing to the futures market for crude oil. These investments are based upon anticipated future supply and demand conditions. The announcement of a long-term commitment by the United States to increase its contributions to the international crude oil market could help calm some of the inflationary influences in the futures market and could provide long-term, meaningful benefit to consumers.

Regulation: Any regulation that imposes costs on the system will be reflected in elevated prices in the wholesale gasoline market, and as demonstrated above these costs will be transferred at some point to the consumer. This is true regardless of the intent of the regulation and Congress and the Administration must recognize this fact.

For example, the anticipated Tier 3 regulations affecting the sulfur content in gasoline will increase the cost of refining operations and could result in some smaller, less-profitable refineries shutting down. This will affect the overall cost structure of the market. Some may believe that the proposed benefits of such a rule justify the costs, but NACS urges both Congress and the Administration not to underestimate the effect additional costs regulations such as this will have on the retail price of fuel.

Further, it is critical that the cumulative effect of various regulations be understood and that these objectives be coordinated to avoid conflict. For example, the proposed greenhouse gas emissions reductions for 2017 – 2025 model year vehicles will result in a corporate average fuel economy equivalent to 54.5 miles per gallon. This proposed rule will make it virtually impossible for the nation to comply with the mandated volumes contained within the Renewable Fuels Standard. Given the projections of these two rules, by 2022 in order to satisfy the RFS every gallon of gasoline in the nation will have to contain 37.5% renewable fuels. This will require the complete replacement of the nation's entire retail equipment infrastructure at an estimated cost of at least $21.7 billion. Further, there will be insufficient vehicles equipped to operate on these fuels. According to EIA's 2011 Annual Energy Outlook, by 2025 only 15.5% of vehicles will be flexible fuel and able to run on the fuel formulations mandated by these two regulations. This is the type of unintended consequences that Congress and the Administration must strive to avoid.

CONCLUSION

The retail fuels market is a complex system that is influenced by a wide number of factors. The best strategy for providing long-term relief and stability to consumers is to enact a comprehensive transportation energy policy. NACS does not believe that improved efficiency, enhanced sustainability, national energy security and economic growth are mutually exclusive objectives. But if they are not pursued in a strategic, coordinated effort they can lead to unintended consequences that can derail progress towards all of the objectives and, in the end, consumers will endure the brunt through higher prices at the pump. Enhancing supplies of traditional energy resources while conducting an orderly transition to alternatives is the best way to benefit consumers.

Mr. WHITFIELD. Thank you, Mr. Eichberger.

At this time I recognize myself for 5 minutes of questions. We do appreciate the testimony of all of you.

Whenever we talk about gasoline prices, we get into this inevitable discussion of moving to new technology versus the internal combustion engine, and the basic question comes out to be, in my view, how much can the Nation afford? You cannot just snap your finger and move to new technology very quickly. And I know, Mr. Weiss, the topic of today's hearing is about gasoline prices and what do we do to get these prices down. And we are not talking about, you know, 25 years from now or 30 years from now, although that is important in the long run. But I was reading, for example, that your organization called for a tax at $9.50 per barrel on imported oil. Now obviously that would raise gasoline prices, so why would your organization be advocating that?

Mr. WEISS. Well first, Mr. Chairman, the proposal is designed to provide money to rehabilitate our crumbling infrastructure here, particularly highways and public transit systems. Doing both of those things will actually reduce oil use here.

Second, we could phase in a proposed oil import fee over a few years so the impact on gasoline prices would be relatively minimal, compared to these swings that we are seeing today, and we take those funds and invest in infrastructure, then we will actually be saving consumers money in the long run.k

Mr. WHITFIELD. But you think you could put this tax on and have a very small increase in actual gasoline prices, is that your——

Mr. WEISS. The rule of thumb is every $10 increase in the price of oil is a quarter or 25 cent increase in the price of gasoline. So if you phased it in over, say, 3 years, you are talking about adding 8 cents to the cost of a gallon of gas at a time where you will be helping consumers save more by increasing their fuel economy by having roads that aren't crumbling, avoiding detours for bridges that are out, helping transit systems which are——

Mr. WHITFIELD. Let me ask you another question. I know you are advocating removal of any tax breaks for oil companies. Now are you also in favor of removing any tax breaks for wind power, solar power, electric cars?

Mr. WEISS. Well as you know, Mr. Chairman, in this country we have a long history of providing assistance for emerging industries, starting—going back—as far back as the railroads, the internet, radios, television. What we are proposing—may I finish, sir? We are proposing that we help these emerging industries like wind and solar. Some of these tax breaks for the oil industries are nearly 100 years old.

Mr. WHITFIELD. Do you realize we have spent millions of dollars and many of these companies have already gone bankrupt, and I don't think that that is protecting the taxpayer dollars.

Mr. Gerard, one question I would like to ask you, when Al Gore was in the U.S. Senate he used to talk frequently that the U.S. possesses only 2 percent of the world's proven oil reserves, and as far as I know, Al Gore was the first person ever to use that figure. There is a difference in proven and unproven reserves. Now when

we talk about the U.S. only possesses 2 percent of the world's proven oil reserves, what is the difference in that and unproven?

Mr. GERARD. I can only assume he uses that particular number to suggest or imply that we have little oil in this country.

Mr. WHITFIELD. Right.

Mr. GERARD. Let me say, first and foremost, we have vast resources here in the United States. In fact, for the past 30-plus years, we have had 85 percent of it off limits so we can't even go out and define, look for it, and identify it. Look at the situation in North Dakota today. Five years ago we thought we had 100, 200 million barrels of oil there. Today it is estimated to be somewhere between 14 and 20 billion barrels of oil under the State of North Dakota. So there are vast resources here in this country.

The term that is being used is a very technical term showing only those that have been proven by drilling, so it shows 2 percent. Even the EIA, the Department of Energy recently said our reserve—our estimated reserve is at least 10 times that, but when you go beyond that, our experience in the Gulf of Mexico, for example, we have developed and produced eight times what was estimated to be there early on. Give us the opportunity. We will invest our risk—we will risk our capital. We can produce a lot of energy in this country by Americans for Americans. We have vast resources.

Mr. WHITFIELD. Thank you. My time is basically expired, so Mr. Rush, I recognize you for 5 minutes.

Mr. RUSH. Thank you, Mr. Chairman.

Mr. Weiss, a growing number of people are concerned that Wall Street speculation is also playing a role in driving up oil and gasoline prices. What is your thoughts on this and how concerned should we be about speculation driving up the price of oil?

Mr. WEISS. Thank you, Mr. Rush. I think we should be very concerned. The evidence is fairly strong that Wall Street speculators and not commercial end users, like Mr. Milburn, for example, are the ones that are driving up prices. The Washington Post reported yesterday that there was an analysis by the Federal Reserve Bank in St. Louis that determined "Financial speculative demand shocks were responsible for at least 15 percent of the huge run up in oil prices between 2004 and 2008." And there is a whole host of other studies that all point in that direction. The Dodd-Frank law does provide tools to the Commodities Future Trading Commission to help reign in Wall Street speculators, but those tools have yet to be implemented and we should urge the agency to do so.

Mr. RUSH. Are there any other actions that we can take to reduce the impact of speculators?

Mr. WEISS. I think the most important one is to have CFTC set position limits for Wall Street speculators, which really limits them to a certain amount of oil they can hold. They worked on their part of this rule, but they have to work out some definitions with the Securities and Exchange Commission, which to my knowledge hasn't happened yet. They are planning on implementing the rule sometime next year. I believe that we ought to urge that they speed up the implementation of that rule.

Mr. RUSH. Twenty percent of the world's oil is consumed by this Nation, and we only have 2 percent of the oil reserves in the world.

We are not going to be able to drill our way out of this problem, as the President has said many, many times. We are producing more oil now than we have in years, but gasoline prices are continuing to go up. Is there any reason to believe that drilling more would result in lowering gasoline prices?

Mr. WEISS. Well first, I believe that responsible drilling is a very important component of our energy policy, because the more we produce here, the less we have to import, the more it helps our balance of payments and you can recycle those dollars in the U.S. instead of sending them overseas. It is unfortunate that in the Department of Interior, for example, just found that 3/5 of the leases for onshore oil production that are held by oil companies are not being developed. There are thousands of leases in the western Gulf of Mexico that oil companies hold that are not being developed. In fact, the Energy Information Administration found that 75 percent of the offshore oil and gas in the lower 48 States is already open for development, so we have got the oil resources there. Let us develop them in a responsible way. By the end of this year, we are going to have more rigs in the Gulf of Mexico than we had before the BP oil disaster occurred in 2010.

So we are making progress in that regard. Let us use our existing leases that oil companies hold but they haven't developed yet.

Mr. RUSH. Well let us get moved to what I will consider some real—some of our realities. You said that the fear of disruptions of oil production in the Middle East creates the price of oil, just the fear of it. Can you explain the—that relationship? How does fear increase the price of oil and cause potential disruption?

Mr. WEISS. Sure. Well commercial end users like, for example, Mr. Milburn and people who are truckers, need to have oil to power their vehicles and we need it to power our economy. If people believe there is going to be a supply disruption, then they will bid on contracts to lock in a certain price now. Once that happens, then other people say wow, the price is going up, I better lock in my contract now before the price goes up any further. And then somebody else says well, you know, Mr. Milburn just locked in his price, I better lock in my price too. And that process leads to sort of an inflationary psychology. And what—it is being driven not by commercial end users, it is being driven by Wall Street speculators who are making 2/3 of the trades right now. Normally commercial end users make about 2/3 of the trade and Wall Street speculators make about 1/3. Now it is the opposite.

Mr. WHITFIELD. Gentleman's time is expired. At this time I recognize the gentleman from Illinois, Mr. Shimkus, for 5 minutes.

Mr. SHIMKUS. I love this committee. I love this subcommittee. I have so much anxious questions. I will try to be calm, but if fear drives up speculation—you know how you drive the stake in the heart of a speculator? You flood the market with commodity product. I mean, everyone talks about the risk taker when they make profit because they bet right. No one talks about the risk taker when he bets wrong and loses everything. You know how you flood the market with oil? You do Keystone XL pipeline. You send an immediate signal to the country—thank you, my fans—you send immediate signal to the country that we are going to open up the third largest oil reserve on earth to the U.S. market. You think

that doesn't affect the speculators? It will scare the bejeebers out of them, and those who take in big positions now will lose their shirt. And that is how you do it.

Then we can talk about the OCS. Another point, just because you have a lease doesn't mean there is oil underneath there. You have to look for it. It takes capital expense. And one more thing, because I am from southern Illinois and we drill for oil in southern Illinois, little marginal wells, great prices. We are doing it right now. I am tired—I am really tired of this attack on drilling, because my little mom and pop drillers, all they want to do is if they don't hit the well, they want to record that as an expense. That is all this tax break for big oil is. If they don't hit, they don't count it as an expense. You can write it off as a business expense if you drill and you don't hit the oil. That is all it is. Now multiply that to a multinational corporation, it is the same thing. If they go deepwater drilling and they don't hit, should they not write that off as a business expense? Sure they should. Just like my mom and pop should do it locally. All right, I got that off my chest. Thank you.

Secretary Chu said we want European gas prices. You know what they are right now? March in London, 8.17 a gallon. That is going to take us off—this hearing is about gas prices, and this administration from day 1 says we want high gas prices. Guess what? They are going to get it. The President was asked yesterday. Oh, I don't want high gas prices now because I am up for reelection. You know, what was the unsaid part of that statement? But I don't mind if they go up after the election. That is the untold part of his response because as we know, the secretary—which we will get a chance to talk to him next week—wants European gas prices for a lot of reasons that we have addressed before.

Let me talk to Mr. Breen a while, because really, the thing that brings us together is really the debate. We are all about energy security, we are all about decreasing our reliance on imported crude oil. Twenty percent still comes from the Middle East. We have got Iran, we have got the Strait of Harmuz, we know we deployed there. Mr. Engel and I have a bill called the Open Fuel Strategy which makes the basic premise, let us break the monopoly of crude oil and a liquid transportation fuel, and let us allow the individual consumer to make a choice on their liquid transportation at the pump. What do you think about that? Have you looked at that bill?

Mr. BREEN. I can't say I have, sir, but in principle, that sounds great to me.

Mr. SHIMKUS. Yes, and I would encourage you to look at it. We have got a lot of great national security guys looking at it. It would be—it would bring all comers—all we got to do is get the liquid blend. My friend from the convenience stores, obviously we have some issues, but once we get the blend, then free the consumer. The monopoly is crude oil. Bring all comers to the liquid transportation market and then compete, and let the consumer—let them fight for the lower price. I have done that before. I drive a flex fuel vehicle. I—when I get a chance, I pump E–85 into that baby. But there was a time I drove up and the E–85 was actually more than conventional unleaded. Being the conservative fiscal Republican that I am, guess what I did? I filled up on the unleaded regular.

I wasn't going to subsidize it. Get the competition. What is the problem with this, John?

Mr. EICHBERGER. The only issue we have with alternative fuels is one, do the customers want to buy them, and two, can we lawfully sell them?

Mr. SHIMKUS. Yes, talk about lawfully sell them.

Mr. EICHBERGER. Lawfully sell them, we talk about E–15, for example. We have to have equipment that is certified as compatible with that equipment—with that fuel or we can't sell it. We are grossly negligent, we are violating a bunch of Federal laws. If we sell it to a customer and they put it in a car that is not permitted to use that fuel, we can be held responsible with a Clean Air Act violation, $37,500 fine, and we could be responsible for voiding a warranty or damaging an engine. Those are things that need to be resolved if we want to bring these new fuels to market.

Mr. SHIMKUS. Thank you, Mr. Chairman. I am going to encourage my colleagues to talk to me about a way to fix that problem.

Mr. WHITFIELD. At this time I would like to recognize the gentleman from California, Mr. Waxman, for 5 minutes.

Mr. WAXMAN. Thank you, Mr. Chairman.

This recent spike in oil—gasoline prices is just too familiar. We have been there before. If you want to fix a problem, I think we have to figure out the diagnosis correctly. You can't cure pneumonia by treating a broken leg. The fundamental problem isn't that we are not drilling enough or even that we are too inefficient. In my view, the fundamental problem is the United States is heavily dependent on a single commodity, oil, and we don't control the vast majority of the oil supply on most of the oil demand. Oil prices are set in the world market, which means that we—even if we produce as much as we consume, we would still have to pay the world market prices for crude. Does anyone on the panel disagree that as long as the U.S. is heavily dependent on oil, we will be vulnerable to price volatility in the global oil market?

Well, I want to ask Mr. Weiss, it has become a Republican mantra that the solution to high gas prices is more domestic production. Do you agree with that notion, and if not, why not?

Mr. WEISS. Thank you. No, I don't agree with it. I think more drilling is an important piece for our national security as we talked about, but it is not going to solve high gasoline prices in the way that you—for the reason you just described. I think what we need to do is begin to invest in alternatives like electric vehicles. Mrs. Biggert of Illinois has a bill that would help create infrastructure for recharging. I believe that is what the President will be talking about today.

Mr. WAXMAN. Well the question that I really wanted you to answer is if we had more domestic production, would we have lower gasoline prices?

Mr. WEISS. No, we would not.

Mr. WAXMAN. And the reason we would not?

Mr. WEISS. Because as you noted, oil prices are set on the world market. The price of oil is about 78 percent of the price of gasoline right now, and it is too easy for any of the OPEC countries to change their production in order to keep the price at a certain level. In fact, the Saudi oil minister in January said that they

thought an ideal price for oil was $100 a barrel. Presumably, they will take actions to try and keep that the case.

Mr. WAXMAN. So if we produce more oil in the United States, it won't make a difference to the world price if the OPEC cartel decides to reduce the supply?

Mr. WEISS. That is correct.

Mr. WAXMAN. Some countries, like Canada, produce more oil than they can use. We are talking about if we can get self-sufficiency on oil, but they have more than self-sufficiency. They produce more oil than they use, and they are still subject to the world market and they suffered from gas price spikes just as we do.

Under President Obama, U.S. oil production is the highest it has been since 2003. You wouldn't know it from some of the comments that were made, but gas prices are still spiking. The idea that our problem is insufficient oil production is a fantasy, and I believe it is a very dangerous fantasy.

Mr. Breen, you are an expert on national security. Do you think that just focusing on production is a dangerous approach?

Mr. BREEN. Yes, sir, I do.

Mr. WAXMAN. And why?

Mr. BREEN. Because as you said, it doesn't change the overall dynamic, and more importantly, it doesn't change our single source dependence. As long as we need this fuel for 95 percent of our transportation sector and virtually all of our military operations, we are stuck with whatever the market does.

Mr. WAXMAN. Mr. Weiss, what progress have we seen from President Obama in reducing our oil dependence?

Mr. WEISS. We have made great progress in reducing our oil dependence. We are using less oil than at any time since February of 2001, and that is even as our economy is recovering. It is due to the oil—I am sorry, the fuel economy standards put into place by this administration that was signed into law by President Bush. The fuel economy standards that the President put in place in 2009 were originally signed into law by President Bush in 2007. They are starting to have impact on reducing oil consumption and that effect will only grow. By the time the final standards are implemented in 2025, cars will go twice as far on a gallon of gas and we will save over two million barrels of oil a day.

Mr. WAXMAN. Mr. Breen, the President has called for eliminating the $4 billion in tax breaks for oil companies, and instead investing it in alternative energy. Would this improve our economy and national security?

Mr. BREEN. Sir, I believe it would improve our national security in that it would incentivize alternatives. Again, the fact that we are stuck with this single source of energy for all of our needs with military and civilian is a huge national security weakness that Iran and others exploit daily.

Mr. WAXMAN. The top five oil companies earned $137 billion in profits last year and gas prices are rising. We have an economic and national security imperative to reduce our dependence on oil, and we are in a tight fiscal situation. I think the President is right. The last thing we should do right now is give the oil companies $4 billion a year in tax breaks.

Mr. WHITFIELD. The gentleman's time is expired. At this time I recognize the gentleman from Texas, Mr. Barton, for 5 minutes.

Mr. BARTON. Thank you, Chairman Whitfield. I would like to ask Mr. Gerard if he knows what the peak production per day of U.S. oil production has ever been?

Mr. GERARD. I don't have that with me, Congressman. I would be happy to get it for you.

Mr. BARTON. Is there anybody in the panel that knows?

Mr. WEISS. I think, Mr. Chairman—again, this is—I am glad we are not sworn in. I don't want to be held to this.

Mr. BARTON. This is not a trick question.

Mr. WEISS. I believe it is somewhere around 10 or 11 million barrels per day.

Mr. BARTON. Yes, and we are—the latest number I have is that we are producing about 5–1/2 million barrels of oil production per day right now. That is as of 2010, and that is obviously 2 years old, so it may be a little bit higher than that.

Mr. WEISS. It is about—excuse me, sir. It is about—almost six million barrels a day now. It is about 5.9, I believe.

Mr. BARTON. So we are at six today, which the trend is up. We have been as high as 10 or 11. We are consuming—my number that I have in my mind is about 20 million barrels a day, it is probably less than that. What is it now?

Mr. DREVNA. Closer to 18.

Mr. BARTON. Eighteen. So we have got imports going down, which is a good thing. We have got domestic production going up, which is a good thing, but we are still importing quite a bit. And most of us on the Republican side do believe that a robust domestic drilling program would significantly improve production, especially if we do not over-regulate hydraulic fracturing, which is now being used for oil production as well as for natural gas production. I am told that all, all of the oil wells that are being drilled up in North Dakota are hydraulic refractured. Is that correct?

Mr. GERARD. Clearly the majority of them are.

Mr. BARTON. They are, so what is a reasonable estimate of—if we changed our policy to actually lease in a timely fashion and drill in a normally regulated fashion on Federal lands as we have been doing on private lands, how much additional oil production per day could we reasonably expect in the United States, including Alaska and OSC, say in the next 4 or 5 years?

Mr. GERARD. Well, a lot of it would depend, Congressman, based on the permit process. Back to the earlier comments about the leases not being used, today in the typical leasing process from the point of acquiring a lease to getting to the point of drilling is somewhere between 3 and 7 years. So you are going to have to look at the permitting process. Earlier it was commented that we have idle leases today. Let me tell you about one so-called idle lease. It is a lease in Alaska today that has been in place for 5 years. The company has spent $4 billion on the lease. They haven't drilled one hole yet.

Mr. BARTON. I think that is the Shell——

Mr. GERARD. It is the Shell.

Mr. BARTON [continuing]. And I think we are finally going to get to drill some this summer. I am told that.

Mr. GERARD. Well let me correct that, if I can. Not to take your time, but what has happened recently is because they have a 475-page oil spill response plan that has been filed, they only have a 3-month window to drill. They are fearful somebody is going to litigate that question and take them through the 3 months window, thus putting them into the sixth year of this lease, which by this administration is defined as an idle lease. So a week ago they essentially sued themselves to try to get a judge to declare the oil spill response plan was sufficient so they could have certainty that this summer during the drilling window they could drill. That is the problem.

Mr. BARTON. On Federal lands, the number that you just gave is 3 to 7 years.

Mr. GERARD. Correct.

Mr. BARTON. Does anybody refute that? I mean, that is a pretty wide range, but even at that, 3 years, compare that with what it would take to get a lease on private lands approved in Texas. How long would that take?

Mr. GERARD. I will defer to other Texans here who say a week, but——

Mr. BARTON. Well I am told 2 days.

Mr. GERARD. Typically it would be considerably less, and it is focused on moving the process so we can produce the activity.

Mr. BARTON. Which is best for domestic oil production, a permitting process that takes weeks or a permitting process that takes years?

Mr. GERARD. Clearly one that takes weeks.

Mr. BARTON. OK, I yield back, Mr. Chairman.

Mr. WHITFIELD. Thank you. At this time I recognize the gentlelady from California, Ms. Capps, for 5 minutes.

Mrs. CAPPS. Thank you, Mr. Chairman, and thank you to each of our panelists for your testimony today.

Mr. Breen, I will start with you, and thank you as well for your military service to our country.

Mr. BREEN. Thank you, ma'am.

Mrs. CAPPS. Operational energy accounted for 75 percent of the military's total energy costs in 2010. Despite the increase in power saving technologies, the Pentagon remains tethered to oil, as you said, and continues to pay the price for our dependence in dollars and, of greatest concern, in lives. The Pentagon knows this is a serious problem. Last year it released an operational energy strategy to transform the military's use of energy, and the President's fiscal year 2013 budget request includes new support for alternatives. As a member of the bipartisan Defense Energy Security Caucus, I strongly support the goals of the administration in this area.

So I want to ask you about the need for the Pentagon to use less energy and develop new clean energy technologies, especially as we try to reign in the budgets and become a more effective fighting force. My first question is what can the Pentagon do for clean energy?

Mr. BREEN. Thank you, Congressman Capps, and thank you for raising this issue because I think it is critical to these hearings.

The Pentagon can do a lot. Every time there is a $10 increase in the price of a barrel of oil, it costs the Department of Defense

about $1.3 billion. That is about the weapons budget for the Marine Corps. That is a huge amount of money. It also costs, as you mentioned, lives. About 50 percent of the convoys that traversed Iraq and now traverse Afghanistan, those dangerous roads, carry fuel. One in 24 of those convoys ends in an American casualty. This is a very costly business, moving this fuel around the battlefield.

As the largest consumer of energy in the Federal Government, the Department of Defense can and is doing quite a bit. The U.S. Navy, for example, is committed to reducing petroleum use by 50 percent by 2015, with a goal of 40 percent of total energy consumption from alternative sources by 2020. We talk about alternative fuel mixes in cars. The Navy is flying the Green Hornet. It is an F–18 high performance strike fighter. These things go twice the speed of sound. They are flying it very successfully on a 50 percent blend that is 50 percent jet fuel and 50 percent of it biofuel derived from the Camalina plant. So if you can do that with a supersonic strike fighter, I am sure you can do it with a car.

Mrs. CAPPS. So conversely, you just—do you want to give another example of what clean energy can do for the Pentagon?

Mr. BREEN. Absolutely, and this, again, extends to fuel and it extends to other things. There is a sort of famous story of one of the Marine Corps senior leaders travelling through Marja, a very contested area in Afghanistan, and taking a photograph on his cell phone of an Afghan man who had a tiny little solar panel outside of his hut, and he sent that back to the Pentagon. He said why is this guy kicking our butts? He is self-sufficient on energy and we are relying on fuel convoys. It is a major issue for operational forces out there in the field.

Mrs. CAPPS. Thank you for answering the question so thoroughly. This relationship is a win-win. Clean energy solutions make our military more effective. They save war fighter lives, and the DoD procurement drives the American clean energy economy. So I appreciate your being on the panel today.

Mr. Weiss, thank you also for your testimony. As Mr. Breen told us, our national and economic security will be strengthened by the military's increased use of clean energy technology. Can you please tell us how increased use of clean energy technologies are going to benefit American families and businesses, and help us prevent these fluctuating oil prices?

Mr. WEISS. Thank you for your question, Representative Capps. I think that these investments, first of all, in these new technologies create jobs. American—the American economy and the American manufacturing economy has always benefited from innovation. We need to continue to innovate n the transportation field by technologies like the Chevrolet Volt, which is the first plug-in hybrid electric vehicle that is commercially available, and it is important to remember there has been a lot of talk about the Volt, but in fact, the Volt combined with the Nissan Leaf in 2011 sold twice as many cars as the Prius did in its first year. It takes time for every technology to be developed and commercialized and then see the price come down. So I think those are the kinds of benefits that we will see.

I also believe, as Mr. Breen was talking about, the development of non-oil based fuels for the military will eventually have commer-

cial application, whether it is for commercial aviation or as a fuel for transportation. I think that is very important as well.

One difficulty we have right now is that with—we have flex fuel vehicles that use the fuel E–85 that is only available in about 2,000 service stations out of about 160,000 nationwide.

Mrs. CAPPS. Thank you very much. I yield back the balance of my time.

Mr. WHITFIELD. Mr. Breen, you know, you mentioned the Green Hornet, which is absolutely true and it is good that they are doing that, but that fuel is costing over $70 a gallon right now that they are using in the Green Hornet.

At this time I recognize the gentleman from Texas, Dr. Burgess, for 5 minutes.

Mr. BURGESS. I thank the chairman for the recognition, and let me just say, because the President came out yesterday and said he wants to improve efficiency energy use in this country by the use of efficiency, and I agree with that. I was an early adopter of the hybrid technology early in the last decade. I didn't buy it so much because gas was expensive, because back then it wasn't. I really bought it for that sense of moral superiority I had when driving on the road, and it continues to this day.

Just like Mr. Shimkus, I got to get some stuff off my chest. Look, we had a hearing in this committee June or July of 2008. It lasted all day. We had all kinds of people here. In fact, we had Walter Luken, who at that time was the acting head of the Commodity Futures Trading Commission, and I kind of wish we had Mr. Gensler here today to ask him some of these questions about the great things he is doing with the Dodd-Frank regulations, because I haven't seen them. However, one of the things we heard that day over and over again was that part of the problem with speculation was that the perception was the market was very tight. And although there might be some additional supply here and there, there was growing concern because of the worldwide demand and that tightness led to the proper environment for speculation to make a difference. And we were also told, just as we have heard I think here today, it was 4 to 7 years to go from drilling to production of product that could be sold, so my question today would be if we had made some decisions about production 4 years ago, we might be reaping the benefits today. And if President Clinton had not vetoed drilling in Anwar in 1996 or 1997, we would have the benefit of that product today, and in fact, we would be selling it at a higher price than was available in '96 or '97, and that would help our balance of trades. So I think I would be all for that scenario.

Let me just also say as a consequence of that hearing on speculation, I have done a lot of looking into this in the time since then, and I do believe that it is possible to manipulate markets. After all, I grew up in a time when the Arab oil embargo was in effect. I remember the cold showers of '73 and '74, but that was an attempt by a sovereign nation to influence political decisions in our country by manipulating the price of oil. I don't know if it is widely reported, but I think it was the collapse of natural gas prices that led to the collapse of the Soviet Union in the late 1980s. So clearly, worldwide events can be dictated by the cost of energy. As we

heard earlier today, without energy, life is cold, brutal, and short, and expensive. So we don't want to go back to those times. We want to have the energy available.

But I do want to ask our witness, Mr. McNally, I mean, your brow was furrowed during some of the discussion that Mr. Weiss was having, so I just wanted to give you a chance to expound on that a little bit.

Mr. MCNALLY. Thank you. I have to work on my body language.

I want to comment on the point that there haven't been interruptions and the market is smooth and normal, and for some odd reason gasoline prices have just suddenly leapt to all-time highs. As President Obama said in his news conference yesterday, there have been severe supply—some supply interruptions. One he mentioned was Sudan. Recently the Congress instructed the Energy Information Agency as part of the sanctions bill in Iran to report on the supply inadequacy of—the supply adequacy and the price of oil outside of Iran. That report came from EIA last Wednesday, and let me just quote one sentence or two. "With respect to supply, the world has experienced a number of supply interruptions in the last 2 months, including production drops in south Sudan, Syria, Yemen, and the North Sea." Also they talked about demand, and they said—about the market they said "EIA estimates the world oil market has become increasingly tight over the first 2 months of the year. Global liquids fuel consumption is at historically high levels." So I guess I want to just correct some facts there.

Mr. BURGESS. And I am just pointing out in that environment, the people who do deal with speculation—there are people who do—that makes their environment much more favorable to make money off of the buying of futures contracts when they never intend to take delivery of the product. And I do wish there were a way to make people eat their own dog food if they make bad decisions. I would like to see the enforcement of those contracts rather than allowing them to roll them over and move that money down the road. I think there are some things that I think Mr. Gensler could do, and for the life of me I don't understand why he hasn't done them.

I have to ask one quick question. I think, Mr. Milburn, the natural gas vehicles—I have got a Peterbilt plant in my district. They make an off the line natural gas vehicle. I noticed this morning that GE and Chesapeake are talking about building some of the infrastructure that would allow more of these vehicles to be used, not waiting on the Federal Government to fund that project. Were you aware of that?

Mr. MILBURN. In the trucking industry, compressed natural gas is not a viable alternative at this time.

Mr. BURGESS. But locally for like our bus market in Ft. Worth, Texas, they run on compressed natural gas. I think the Metro buses outside here——

Mr. MILBURN. Yes, sir, that——

Mr. BURGESS. So you can in certain applications?

Mr. MILBURN. In certain—yes, sir, in certain applications yes, it can be a viable alternative. For municipalities, for smaller areas, but the range of compressed natural gas vehicles in the class 8 markets today are not sufficient for us in our operations.

Mr. BURGESS. But now you have two private companies making the investment to the infrastructure, and I would say that is a good thing. Waiting on the Federal Government, we are broke. We are probably not going to be able to help you.

Mr. WHITFIELD. Gentleman's time——

Mr. BURGESS. But I would look to the private sector to do this.

Mr. WHITFIELD. Gentleman's time is expired. At this time I recognize Mr. Gonzalez of Texas for 5 minutes.

Mr. GONZALEZ. Thank you, Mr. Chairman.

I know we led off with opening statements and everyone in this room heard about the gas fight during the Obama years of his presidency. But I guess I need to ask, who was President on December the 17th, 2001? It was George W. Bush. The price of gasoline for that week was $1.04. Who was President on July 7, 2008? George W. Bush. Average weekly price of a gallon of gas, $4.05. Neither President Bush nor President Obama can really control the price at the pump, and I wish we would just acknowledge that. The issue is not that we have not found greater resources and because of technology we can draw more product out of the ground. That really shouldn't be the issue. The issue should be is how do we free ourselves from market manipulation that is going to continue, world markets, emerging countries that are going to be our biggest competitors.

Mr. McNally, you must admit that if you own the oil, you have the contract, and you are out there in the marketplace to sell it, it is going to go to the highest bidder. It is that simple. If you have a customer in the United States that is paying only a dollar for something but you can sell it to someone outside our boundaries for $2, you are going to sell it for $2. Those are market principles. Those are free market forces working, and we all agree with that. It is going to continue as long as we continue to say just produce more product, continue dependency on it. This is not about dependency on fossil fuel that we are importing; this is about dependency on fossil fuel, period. When we started this debate, we always had it in the context that fossil fuel-based transportation fuel was transitory in nature, that we were transitioning to something else. We have stopped, for all intent and purposes, and the problem with what we are discussing today, it gives a false sense of security that if we continue this, just because there is more supply, that everything is going to be all right. I don't believe that. It is a transition fuel, but I believe that it is going to be a number of years that we are going to be still dependent on fossil fuel for many, many reasons.

Now, we can't control this. Not the United States, not our domestic producers, not our Canadian friends, not our Mexican friends, all in North America. The Saudis couldn't do it in 2008. Mr. McNally, you know what I am talking about, because President Bush asked, increase production and the Saudis said we will do it, and they did. But then they said hey—in all those cables that came out later, what did they say? Hey, it is not about supply, it is about speculation. And we better do something about how this is being controlled and who owns it, and how they are determining the price. We are not going to stop that. I don't see that it is going to stop, and I know that Dodd-Frank and the commodities futures

and such—I don't think we are going to stop it, because market forces are market forces. Fiduciary duties to investors will always remain the same. You will sell it to the highest bidder.

Mr. Drevna, if you are going to tell me that because it is based in the United States that somehow—and it should be cheaper because transportation and other costs, and if you have a competing bid that is higher, that you are not violating your duty to your investor or to your shareholder, we have got problems. So I have got 1 minute, just yes or no, and I am going to ask this to the entire panel. Do you believe that this country should continue to rely on fossil fuel-based transportation fuels, that is, for the next 25 years before we make any real progress? Yes or no.

Mr. MCNALLY. I believe we will, not that we should, but we will.

Mr. GERARD. Sixty-two percent of our energy today is oil and gas. The administration will tell you 57 percent of our energy in 2035 will still be oil and natural gas.

Mr. DREVNA. Mr. Gonzalez, 60 percent—57 to 60 percent of the crude oil that we use in this country is imported. We do not export crude oil. We get crude oil from a number of sources. Let us get it from our own country. Let us keep the American refineries working with American jobs, exporting and supplying our own costs consumers.

Mr. GONZALEZ. I think we exported a tremendous amount of refined products last year.

Mr. DREVNA. Well, refined products, sir, refined product, not crude oil.

Mr. GONZALEZ. Well, you know, to the customer, it is called gasoline and that is a refined product.

Mr. DREVNA. But we don't——

Mr. GONZALEZ. And I am really wondering how I explain to my constituent that we are exporting a tremendous amount of it, and yet, we are still charging them $4 a gallon for the refined product.

Mr. MILBURN. May I answer that, Mr. Gonzalez?

Mr. GONZALEZ. We will discuss this a little later, Mr. Milburn.

Mr. MILBURN. Thank you.

Mr. GONZALEZ. I just want to know if you guys see the next 25, 30 years going down the road that we are going down now.

Mr. MILBURN. I do, sir, and until such time as technology can provide me with an alternative-based fuel that is not going to drive up the cost of my truck and my operations, I am still going to have to rely on diesel.

Mr. WEISS. With the kinds of investments that are suggested by Representative Biggert's bill and Representative Sullivan's bill for electric gas and natural gas trucks, I believe that no, we will not be entirely reliant on oil for our transportation system.

Mr. BREEN. Sir, I think it would be a tragic national mistake if we were still reliant. Our military leaders are doing everything they can to get us off of this stuff, and the rest of us should follow suit.

Mr. EICHBERGER. Diversification will happen, but it is going to take a very long time. In the interim, petroleum is going to be the source of transportation.

Mr. GONZALEZ. Thank you very much. Thank you, Mr. Chairman.

Mr. WHITFIELD. At this time I recognize the gentleman from Texas, Mr. Olson, for 5 minutes.

Mr. OLSON. I thank the chairman and welcome to the witnesses. Thank you all for coming and giving us your time and expertise.

Being a former naval aviator, it is a pleasure to see someone else who has worn the uniform of our country. And Mr. Breen—do I call you Mr. Breen, Captain Breen, Major Breen?

Mr. BREEN. Just mister these days, sir.

Mr. OLSON. Mister these days, OK, sir. My first question is going to be for you, Mr. Breen. Throughout your written testimony, you frequently use the term "dependence upon a single source of energy, oil," and you mentioned countries that don't like us to benefit from our dependence on foreign oil. You specifically mentioned Russia, Venezuela, Iran—although I know you know that we don't get any oil directly from Iran—but you didn't mention Saudi Arabia, even though one-half of our foreign imports come from Saudi Arabia. My question for you is what about Canadian oil?

Mr. BREEN. That is an interesting question. Sir, as you say, it is——

Mr. OLSON. I got a little bit more, here we go.

Mr. BREEN. OK.

Mr. OLSON. Little—we are pilots, you know, we——

Mr. BREEN. I should have brought my glasses to the hearing.

Mr. OLSON. This is the Keystone XL pipeline, and as you know, the Keystone XL pipeline will create 20,000 jobs, bring 800,000 barrels of oil to the United States, the Gulf Coast area where I represent. Canada has been one of our greatest allies. You were there. You know that they lost almost 400 of their soldiers fighting beside us against the war in Iraq and Afghanistan, fighting the war against terror. In recognizing these facts, last week the administration announced that they were not going to oppose the construction of the first portion of this pipeline from the farms here in southeast Texas, my home, Port Arthur/Houston, up to Cushing, Oklahoma, this part there. And Jay Carney had a great quote when they announced what they were doing. He said "Moving oil from the Midwest to the world-class, state-of-the-art refineries on the Gulf Coast will modernize our infrastructure, create jobs, and encourage American energy production." And so my question for you is, Do you support the administration's decision to go forward with this part of the pipeline? Yes or no answer, please, sir.

Mr. BREEN. Sir, I don't have an opinion on it because it is not going to change the global price of oil, and that is my biggest concern. Based on the information I have seen, the dynamic is fairly ironclad. U.S. demand is fairly static, U.S. production is up, but global demand driven by China and India, which are never going to need less oil than they do now and are ever going to need more, that demand is continuing to go up and as long as it does, the global price goes up. As you said, it doesn't matter——

Mr. OLSON. I have to cut you off. I only have a little time here, but one thing that concerns me most about your written testimony is you never mention the purely domestic abundant source of energy we have, natural gas used for transportation. I mean, I want to—here you concluded your written statement with this comment. "I respectfully conclude with a simple request: lead us in building

an alternative energy economy that can break our dependence on oil, ensure our future prosperity and security, and finally put Americans in control of our own energy future." Natural gas is the answer to your request. And all these enhanced recovery techniques, directional drilling, have changed the paradigm of U.S. energy.

I toured a UPS plant—facility in my home district in Stafford, Texas. They got about 200 trucks there. About 40 of them are being converted to pressed natural gas now. They actually built a facility there to refuel them. The Clear Creek School District, they are converting about 60 of their buses to natural gas, again, built a 60-pump, for lack of a better term, facility right there off of the Gulf Freeway to get the school buses powered by natural gas. It is here. It is real. It is clean. It is cheap. It is American. It gets us off foreign oil. I am just concerned, was the omission of natural gas in your testimony, was that an oversight?

Mr. BREEN. No, sir, it wasn't. As you may recall, I mentioned it in my oral testimony. I think one of the things that is fantastic about the President's plan as he announced it today is that it embraces choice, and one of those choices for communities in this race to the top is exactly what you said, compressed natural gas. There is also something in the plan the President has put forward designed to create corridors for compressed natural gas trucking to get us closer to the point where Mr. Milburn and his colleagues are able to use that fuel for longer and longer distance trucking.

So I mean, again, it is not a silver bullet solution, sir, it is a silver buckshot, and I am in favor of just about anything that is going to safely and cleanly give us choice.

Mr. OLSON. Again, I appreciate—I notice that you did include the comments about the President in your oral testimony. I appreciate that.

I just want to ask one more question about some of the comments that have been coming out of the administration that some of my colleagues alluded to. When the President was running for office, he made the statement that under his policies, energy prices will necessarily skyrocket. Our current sector of energy, when he was—that same time period, the quote is that he said, "Somehow we have to figure out how to boost the price of gasoline to levels in Europe," which is about $10 a gallon. Recently Secretary of Interior Salazar said, "I will object to OCS drilling even if the price at the pump goes to $10." Surely you don't support increasing the price of gas for the American people to $10 per gallon?

Mr. BREEN. No, sir, I think that would have a catastrophic impact on our economy and also on our military operations, but unfortunately—pardon me, Mr. Chairman, but unfortunately given the fact that 95 percent of our transportation sector is still reliant on that single source of fuel, if it goes that high we are going to have ot pay unless we come up with alternatives.

Mr. OLSON. Well, you are a man of intellect, I can see you have a closed mind. Come on down to Texas, I would love to take you around.

Mr. BREEN. I would love to go, sir. Thank you.

Mr. WHITFIELD. The gentleman—at this time I recognize the gentleman from Massachusetts, Mr. Markey, for 5 minutes.

Mr. MARKEY. Thank you, Mr. Chairman. We had been told by the American Petroleum Institute in their TV ad campaign that voters all over the country are voting for American energy, but is American energy really what the American Petroleum Institute is representing? The American Petroleum Institute tells us we need Canadian oil from the Keystone Export pipeline to strengthen our energy security needs. Maybe the institute should be called the Canadian Petroleum Institute. But wait. You don't even want to keep the Canadian oil here, since the API says that my amendment to keep Keystone oil and fuels in this country would make us just like North Korea. Does that make the API the South Korean Petroleum Institute? We are told by the API that the adoption of my proposal to keep Keystone fuels here would cost us tax revenue, even though the oil is headed straight to a foreign trade zone where it will be refined and re-exported tax free. So maybe it should be called the Cayman Islands Petroleum Institute. We are told by the API in their TV ad campaign that eliminating the $4 billion in tax subsidies big oil gets each year would send us back into a depression, even though the big five oil companies spent almost 10 times that much buying back shares of their own companies in 2011. I guess that would make you the Wall Street Petroleum Institute. We are told by the API in their TV ad campaign that we could create one million new oil and gas jobs in the United States, even though Exxon, BP, Shell, and Chevron made $546 billion in profits between 2005 and 2010 and cut 11,200 jobs in the United States.

So what is the real story about the American Petroleum Institute and its members? Big oil is cutting American jobs. Big oil is fighting efforts to end their free oil and tax holidays, and big oil wants to sell our oil and gas to the highest international bidders, even if it means Americans all over our country will pay more at the gas pump and more in electricity each month. It isn't the American Petroleum Institute. It is the World Petroleum Institute that you are representing here today, the huge multinational corporations who have no loyalties other than their shareholders, and I appreciate that. I appreciate the loyalty to shareholders, but it is not about American energy in the United States.

So let me begin. Mr. Gerard, earlier you said that API supports energy produced by Americans for Americans. So let me ask you, does the American Petroleum Institute support my amendment to require that the oil from the Keystone pipeline be kept in the United States for Americans?

Mr. GERARD. First, let me say, Congressman, I am thrilled that you are watching our advertising, but I clearly have to come up and spend a few more minutes with you to help you better understand what it really means——

Mr. MARKEY. Do you want the oil from the Keystone pipeline—do you support keeping it here in the United States or allowing it to be exported? Yes or no?

Mr. GERARD. We strongly oppose your amendment, like the majority of the committee did because it doesn't make economic sense for the oil and gas industry anymore than it makes sense for the farm community——

Mr. MARKEY. That is fine.

Mr. GERARD [continuing]. Or exporting Caterpillar or any of the other products we make in America by America.

Mr. MARKEY. It is Keystone Export pipeline, just so we get it down. Does the API——

Mr. GERARD. Well let us be clear that the experts will tell you the vast majority of that will be consumed, refined in the United States and will likely displace imports from Venezuela and Mexico.

Mr. MARKEY. Does the American Petroleum Institute support my bill to call a time out on any further approvals of liquefied natural gas export terminals so we can keep all that new natural gas from Marcellus, Barnett, and Utica here in America for Americans and keep prices low here? Do you support not having it be exported around the world?

Mr. GERARD. If we, just like in the case of gasoline today, produce more than the market demands, exports are a good thing. The President has called on us to double our exports in this country——

Mr. MARKEY. It is going to raise——

Mr. GERARD. They create jobs, they bring billions of dollars——

Mr. MARKEY. The Energy Information Agency says that it is going to increase rates of natural gas——

Mr. GERARD. The positive free market thing to do——

Mr. MARKEY. How about the oil that we drill for off of—under the Republican proposal that we voted on 2 weeks ago off of the beaches of Florida and California and New England? If we find the oil and gas there, my amendment said on the House Floor keep that oil and gas here. How about the American Petroleum Institute, keep it here or allow it to be shipped overseas?

Mr. GERARD. The key is to add supply to the marketplace as we talked about today, because it is supply that will change the global economic dynamic and put downward pressure on the price of crude oil, because it is the crude oil——

Mr. MARKEY. If you say drill here, drill now, there will be less.

Mr. WHITFIELD. Gentleman's time is expired.

Mr. MARKEY. Drill here, ship there, pay more for American consumers, and I just think everyone has to understand that the gas and oil industry is interested in shipping out——

Mr. WHITFIELD. Gentleman's time is expired. At this time I recognize the gentleman——

Mr. GERARD. Mr. Chairman, let me just say first, the Congressman is wrong and I would be happy to come by and visit with you about all that——

Mr. WHITFIELD. At this time I recognize the gentleman——

Mr. GERARD [continuing]. And educate you further. Thank you.

Mr. WHITFIELD [continuing]. From Kansas, Mr. Pompeo, for 5 minutes.

Mr. POMPEO. Thank you, Mr. Chairman. You know, you can see on this side it is—there are a lot of folks who just don't get how the—we come to these hearing and hear folks try to repeal the law of supply and demand. We hear folks who normally talk about favoring exports trying to create enormous programs so that Americans can manufacture here at low cost, fight low cost energy sources for our manufacturing companies. And you see folks on this committee who are arguing about all these Chinese imports they

don't like and we can't compete around the world and we can't export, arguing we shouldn't export. It is a stunning thing for those of us on this side to listen to.

I want to talk a little bit about this notion of speculation, Mr. McNally. Every time—I will keep this simple. Any time somebody goes long in a particular commodity, who is on the other side? There is someone with an equal and opposite position.

Mr. MCNALLY. For every buyer, there is a seller.

Mr. POMPEO. And for every trade that there is a winner, there must be a loser. And so we come and have these hearings and we hear about speculation when the price of commodities go up, but I have seldom witnesses—I am new, so I would not have been part of this before—but I have seldom seen these hearings when the price goes down. Would there be equal speculation about folks trying to drive prices lower as well? I am confused about why speculation is a one-way ratchet, according to at least some who have testified here today.

Mr. MCNALLY. I think the American public and members of Congress are more concerned about rising prices, so they are more concerned when prices are going up and people are buying and they are less concerned when it is selling, so market participants don't get the credit when contributing to downward price movement or helping prices peak when they are rising.

But we don't have to take it from me. the IEA, the CFTC, the EIA, officials at unbiased regulatory agencies with the access to the information who have looked at this closely have concluded that financial market participants have not been distorting the price of oil.

Mr. POMPEO. I appreciate that.

Mr. Gerard, I want ot ask you, you are experienced in this as well. Natural gas 2.50 at MCF, was 14, driven by speculation?

Mr. GERARD. Well, what has happened, Congressman, as you well know, in this country because on State and private lands we are producing trillions of cubic feet of natural gas. There have been recent announcements by a number of major manufacturers who are going to bring jobs right back here ot the United States because the market has driven the price of natural gas down to where it is affordable, it is reliable, and if we are allowed to produce it in this country it has multiple implications for us, job creation, revenue to governments, and energy security.

Mr. POMPEO. So supply and demand.

Mr. GERARD. Supply and demand.

Mr. POMPEO. So 2.50, that is not some boogeyman on Wall Street or——

Mr. GERARD. In fact, Congressman, if I can, I don't want to take your time, but there is an experience we had in July of 2008 that was alluded to earlier that we ought to go back and look closely at. The price of crude oil drove to $145 a barrel. Then President Bush announced the opening of the Outer Continental Shelf and lifted the moratorium. The price of crude oil over 3 days dropped $15 a barrel and continued to move down. Markets are driven on a global basis by expectation. If the market heard the President of the United States say I am serious about producing my vast energy resources, you will see an impact in the market.

Mr. POMPEO. Yes, I would agree with that. I would love to see that from our President.

Let me talk for a second—Mr. McNally, you talked a little bit about the Strategic Petroleum Release. We had one during my time in Congress last year. To what effect?

Mr. MCNALLY. The release you are referring to is the sale of 30 million barrels announced on June 23 of 2001, and the price of oil dipped for 4 days and then made a new high.

Mr. POMPEO. And the President continues to talk about an additional release from the Strategic Petroleum Reserve. What would your expectation be that would result from such a release?

Mr. MCNALLY. In my view, as long as the underlying supply demand fundamentals remain tight and as long as the prospect of a potential conflict remains with Iran, were we to release oil now and achieve a day or two dip in supply, we would be releasing cheap oil to traders who would buy it and expect a profit from it later this year.

Mr. POMPEO. Great, not a very effective thing for folks who are driving their cars around or Mr. Milburn, who has got to drive his vehicle around and deliver product to consumers all across the country.

I yield back the balance of my time. Thank you.

Mr. WHITFIELD. At this time I recognize the gentleman from Texas, Mr. Green, for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman.

Eddie, I want you to sit here. You know, for one thing let me follow up my colleague from Massachusetts. Nobody is going to build a pipeline from Canada to Texas and Louisiana to export the oil. You know, we have the biggest refinery complex between literally from the Mississippi River down to Corpus Christi, Texas, and I know the pipeline is supposed to send in maybe a million barrels a day. I currently represent five refineries that need a little less than a million barrels a day, and that is just in the district I represent. So it is a huge amount and we want it, but we are not going to export that oil. We do export refined products. Just because we export steel—and I am sure my colleague from Pennsylvania loves that, and I liked that when I used to have steel plants. We want somebody else to buy our products that we make. So I don't want to export the oil, I want to export the refined products or the chemicals that we make from the natural gas. I would rather not export natural gas. But if we can have the downstream jobs in the chemical industry, then let us export those products. But we still need to export natural gas because we had people in '05 after we streamlined the Federal permitting for importing LNG, now because of success in hydrofracking, we have so much we need to export it. Because again, I have a lot of companies that would really like to see that export market, and again, if we can use it here, let us use it, but if we can't, let us help our balance of trade with it.

Mr. Gerard, API claims that the oil and gas earnings are typically in line with the rest of the U.S. industry, averaging about 7 cents for each dollar of sales over the last 5 years. Is that true?

Mr. GERARD. That is correct.

Mr. GREEN. Where did you get the information?

Mr. GERARD. We developed this information by the Bureau of Labor Statistics. These are governmental numbers.

Mr. GREEN. Thank you. One of the concerns that I have is we reconcile to push to eliminate the Section 199 as the manufacturing deduction that allows all U.S. manufacturers to take a 9 percent deduction on their costs while limiting the natural gas industry to 6 percent. One of my arguments here is that energy production is manufacturing. It is domestic manufacturing. Why would we want to punish domestic energy production by a lower percentage?

Mr. GERARD. I would hope we wouldn't, but that is what the current law is. We are limited to 6 percent, and the President's proposal suggests that that provision of the tax code which is allowed to many other industries be repealed for only the oil and gas industry. That is what he describes as a subsidy. We get no subsidies in the oil and gas business.

Mr. GREEN. Again, natural gas is large companies that are—energy companies are large companies that produce in the United States, they employ United States citizens, and they are going to—they are getting treated differently than other manufacturing companies, and that is just not fair because a few years ago we commissioned a poll on the Democratic side on domestic manufacturing. We showed that in the South, the support for domestic manufacturing was higher in the South than it was in Ohio, Pennsylvania and those States. And somebody said well, do we still have textiles in North Carolina? I am not so sure about that, from the Mississippi River to Corpus Christi, Texas, our manufacturing is refined products, chemicals, and things that come from the energy industry. And that is manufacturing. Those jobs pay just as good as anywhere else, and I don't think they ought to be punished.

Mr. Drevna, you talked about anticipated Tier 3 regulations affecting the sulfur content in gasoline would increase the cost of refining, could result in smaller, less profitable refineries shutting down. Could you elaborate on this? And I am asking because I know my colleague from Pennsylvania is concerned about the two near Philadelphia shutting down. We have actually expanded ours in our district. Can you talk about that?

Mr. DREVNA. Yes, sir, Congressman Green. Thank you.

Tier 3 gasoline would take the current sulfur level of gasoline from 30 down to less than 10, another 90 percent reduction. We have already spent $9 to $10 billion in taking 90 percent out of the gasoline in Tier 1 and Tier 2 from over 300 down to 30, and it cost, like I said, $9 billion to $10 billion. The additional 90 percent would cost upwards of $20 billion to get those last little bits of molecules that don't want to come out. The question is why? The question is what is the net environmental impact on taking it down, and our analysis says it is nil, because autos are already marketing—20 different brands of autos are already marketing their product under Tier 2 gasoline as a Tier 3 vehicle because of how the engines are made. It goes back, Congressman Green, to the conflicting regulations that we see and how costly they are ultimately to the consumer. We are going to lower sulfur more at an unprecedented amount of dollars; therefore, we are going to make—raise CO2 emissions at the refinery because it is a heck of a lot of a more robust treatment that you need to get those little

bit of sulfur molecules out, and then the EPA is going to turn around and say well we got to lower greenhouse gas emissions. Well we are in this——

Mr. GREEN. Let me interrupt you so I can get one more statement in to Mr. McNally. The President took the 30-year moratorium off of the Executive Order in June of 2008. A Democratic Congress in September took the 30-year moratorium off the Department of Interior for exploration in Outer Continental Shelf. So we have a bipartisan support for more domestic exploration, and that is part of our problem. We need more supply. But if you drill an oil well in your backyard, believe me, you are going to want $100 a barrel because you are not going to sell it any cheaper, but we do need to get more supply to the market.

Mr. Chairman, I know my time is up.

Mr. WHITFIELD. At this time I recognize the gentleman from West Virginia, Mr. McKinley, for 5 minutes.

Mr. MCKINLEY. Thank you, Mr. Chairman. I have got a series of questions, maybe building back a little bit just quickly on the thing Mr. Barton was talking about. There is a chart that talks about how production is down but prices are up. Back in 1985, we were drilling—producing about nine billion—nine million barrels a day and we were paying $1.34, now we are at 5.3 million and the price is 3.79, so I think he is on to something there. But more importantly is I am trying to understand, all of you began your remarks, a lot of you talked about speculation. I am trying to understand the role of speculators. Is this a recent phenomenon, these speculators, or just in the last 3, 4 years? Mr. McNally, can you just touch on that briefly? Is this a recent phenomenon? Have speculators been able to buy into the oil market for longer than 3 years?

Mr. MCNALLY. Yes, sir, starting in the early 1980s we shifted from what we called a posted price for oil to pricing it in the futures markets in the New York Mercantile Exchange, and that futures market is composed of physical participants, producers of oil, users of oil like airlines, and——

Mr. MCKINLEY. Thank you, because am curious about this because I went back and looked at what crude—what happened to crude during the four events that I looked at, the Iran/Iraq wars, back in '81 and '87, and when you look at that and the net effect of that time from begin to the end, actually price of crude dropped up. During the seizure, when we had that crisis that was there and it was on the front page of every American paper about our 53 Americans seized in Tehran, crude didn't increase. During the Gulf War, it went about $10 a barrel. And during the Yom Kippur War, it went about $22, so going back to what was remarked was if you look at those numbers, you are only talking about 25 cents—I shouldn't say only, but that is an increase. How do we get from—where was it, $1.85 at the beginning of this administration to now at 3.79 if crises of global magnitude are only having 25 cents?

Mr. MILBURN. Mr. McKinley, may I interject here?

Mr. MCKINLEY. If you could.

Mr. MILBURN. Regulation in the trucking industry by the EPA has driven up our costs on a gallon of diesel fuel. Eight years ago when I started driving a truck, we didn't have the ultra low sulfur diesel that we do today. You know, we are less than 15 parts per

million on the ultra low sulfur diesel versus the old regular diesel. Back then, diesel was 30 cents a gallon less than a gallon of gasoline. Today, on the street, diesel is over 30 cents a gallon higher than a gallon of gasoline.

Mr. MCKINLEY. If I could recover my—I concur with what you are saying. I am just saying I think that speculation has been used as an excuse perhaps. Are they a player? Of course they are, but are they that dramatic when you look at the sheer numbers of it? I am not so sure. I think the regulations and other—but let me pose a question that is more hypothetical.

If we produce no oil in America and we refine nothing, what we will be paying in America for our oil and gas? Ten dollars, what they are paying in Europe?

Mr. DREVNA. That is—a hypothetical is difficult to answer. What—we would be producing nothing in America because mostly everything we produce begins with fuel, begins with energy, begins with petroleum products.

Mr. MCKINLEY. Why is this administration making it so difficult? If we understand that if we don't produce anything, if we didn't drill at all, we are probably going to pay 9 to $10, but if we drill, then we have problems. Look during the Keystone pipeline discussion. How many people—and you heard the amendment that was offered. We don't want any of it to go overseas, it is only to be consumed in America. Are we not in a global market or not?

Mr. DREVNA. That is the fallacy of the argument, Congressman McKinley, is that we are in a global market but there are certain folks who say well, we can do something different within our own market. Maybe one admits we are in a global market, but we are going to have some different kind of economic system in our market. It simply doesn't work that way. As Congressman Green pointed out, you know, exports for us are a major part of it, keeping American jobs and American workers here are a major part of it.

Mr. MCKINLEY. Well let us just close—I have 18 seconds—17 seconds left on it. If we did—go back to that premise, that hypothetical. If we drilled none, and that is what I think this administration would like, to wean us off our fossil fuels—if we did not drill in America, what would be the cost of gasoline in America?

Mr. DREVNA. The cost I can't——

Mr. MCKINLEY. Project.

Mr. DREVNA. I could just project that China, India, Russia, Brazil would be ecstatic.

Mr. MCKINLEY. Would be what?

Mr. DREVNA. Ecstatic.

Mr. MCKINLEY. Pretty sure, because why? We would be paying $10 a gallon?

Mr. DREVNA. If not more.

Mr. MCKINLEY. OK, thank you.

Mr. WHITFIELD. Thank you, Mr. McKinley. At this time I recognize the gentlelady from Florida, Ms. Castor, for 5 minutes.

Ms. CASTOR. Thank you, Mr. Chairman, thank you, gentlemen, for being here today. I represent the State of Florida and we are very sensitive to gas prices because we are a large State. We are a very dynamic State, and we are very spread out. But also because our economic is integrally tied to travel and tourism. It really

ticks people off at home because it seems like every year at spring break or the summer driving season there is some racket because of gas prices go up, and people, our neighbors and businesses, they are very sophisticated. They understand there are things that are outside of their control or the government's control. For example, the explosion of demand across the globe, particularly from China, you know, they don't have much control over that, or term oil in the Middle East that complicates the market. But there are some things that are within our control that they expect us all to focus on and work together on. One is domestic production, and when you explain to folks now that the United States is a net exporter, they are very surprised because for decades and decades and decades we have relied on imports. So that is very positive there, you know. The number of oil rigs operating in the United States has quadrupled in just the past 3 years. There are more rigs operating in the United States than in the rest of the world combined, and we are sensitive to that in Florida because we—while we support domestic production, we want it to happen in the right places and with the appropriate safeguards.

What else is in our control? Fuel economy. This—we didn't make much progress in the '80s and '90s, but boy, are we on the right track now to put some dollars back into the pockets of our hard-working families because what we have done and the Obama administration is built upon now is our direction to make sure that cars achieve 54 miles per gallon by 2025. That is very positive for families. In fact, a member of my family bought one of these vehicles. He gets 50 miles per gallon, and I know Mr. Eichberger, you don't appreciate, he is driving by your stores and enjoys doing that, no matter what price is posted. Fifty miles per gallon. And so we have got to continue to boost that and encourage that.

What else is in our control? Speculators. They—people just know that they are being taken for a ride, that there is significant market manipulation, and Mr. Weiss, I am going to ask you to explain to us the difference between the folks that should be in that market because they control oil, but there are people outside of the oil markets who get in and take these prices up for a ride and it is costing all of us.

The other thing that is in our control that we have got to take action on is the—is don't ask consumers to pay twice. Don't ask us to go to the gas pump and pay and then when we file our taxes, we have to pay $4 billion more every year to the oil and gas companies. That is not fair. That is not fair the five largest oil companies made over $137 billion in profit last year, and with our debt and deficit or the things we can do with $4 billion annually, we have got to turn this around.

I would like, Mr. Weiss, also—secondarily, ask what—if we took that $4 billion, what is the best bang for the buck if we took a significant portion of that and plowed it into—you tell me, diversification, alternative fuels, doing more on fuel economy, unleashing the good old American know-how and technology to get us off this long-term oil addiction.

Mr. WEISS. Well those are a lot of questions. I will do my best.

When it comes to speculation, there is basically two kinds of people in the market. Commercial end users like in airlines or refinery

or an oil company that take physical possession of the product when the contract is due, and then there are Wall Street speculators, money managers, pension funds, hedge funds that are there just trying to make a profit by guessing whether prices are going to go up or down. Traditionally, according to a study by McClatchy, traditionally the end users, commercial users are about 2/3 of the trades and the Wall Street speculators are about 1/3. We saw in last year it has been reversed. About 2/3 of the trades are now Wall Street speculators and 1/3 are end users. That is one of the signs that they are involved in the market. In addition, Mr. McNally talked about a report that the CFTC did in the summer of 2008 that said there was no speculation involved in the record oil prices. Well that was a draft report. The final report which came out in 2009 said, in fact, there was, and there is a whole host of studies, at least a dozen, that I could send the committee for the record if you are interested, that list—that suggest that speculation did play a role, including one by the Federal Reserve Bank of St. Louis that the Post just reported about yesterday.

Mr. WHITFIELD. Thank you. At this time I recognize the gentleman from Virginia, Mr. Griffith, for 5 minutes.

Mr. GRIFFITH. Thank you, Mr. Chairman. I just have to say coming from coal country that nobody has mentioned coal. There are ways that we can use coal to increase our fuel. I like to talk about the four D's: drill, which we have talked about a lot today; dig, which includes our coal resources. We are number one in the world. Let us not forget we have got it. Discover, which of course, includes, you know, finding new ways to use new technologies and use old fuels and new technologies as well, which our universities and think tanks should be working on, and last but not least, we have also heard today about deregulating, which means the EPA has got regulations coming out of our ears that affects every sector of our market and we are consistently seeing problems.

And along those lines, Mr. McNally, could you tell me, is there one regulation in particular that is so onerous, so hard for business in your area or your field to deal with that is preventing or limiting production or increasing employment? Can you name me one?

Mr. MCNALLY. Well I am just in the research and analysis business, but I would think—and my friends in the industry can speak perhaps better, but I think the biggest concern or two really, one would be that the government is going to stand in the way of infrastructure projects that are needed to get investment in domestic oil and gas production, and the second would be uncertainty about regulation of hydraulic fracturing going forward. That is probably one of the biggest concerns I think industry has about investment.

Mr. GRIFFITH. All right. Mr. Gerard, did you have some thoughts on that?

Mr. GERARD. Very quickly I would just add three things. The first one is access itself. That is a decision on the part of the administration. They can make it today. The second one is the lag time in permitting that Congressman Barton talked about. If you are given access and you can expedite that permitting process, it will happen quickly. The third one is, which goes back to the comment the Congresswoman made earlier, there is always talk about subsidies the oil and gas business for taxation. We get no subsidies

from the tax code, but more important than that, today's hearing is on gasoline prices. Congressional Research Service has looked at the proposal, the President's proposal, to discriminate against our industry and repeal those standard business deductions that we receive and concluded that it would have the effect of decreasing exploration, development, and production while increasing consumer prices and possibly increasing the Nation's dependence on foreign oil.

Mr. GRIFFITH. So what you are saying is that third D, discovery, which would also include exploring, would go down and prices would still go up?

Mr. GERARD. It is a net adverse hit to our ability to impact the price of gasoline the Congressional Research Service views.

Mr. GRIFFITH. All right. Let me ask you, Mr. Breen, if I might for a second. It has been said that 70 percent of American casualties in Iraq and Afghanistan have been sustained on logistical missions, i.e., convoys. If our troops had more energy efficient generators, batteries, and vehicles without any deduction in safety or functionality, we can lessen the amount of required supply missions and reduce our troops exposure to attack. Such advancements are obviously positive, but if we convert, as I think I heard you suggest, if we convert our military vehicles and aircraft to biofuel, such as the Green Hornet in your testimony highlights, what is the difference between a convoy that transports ethanol and one that transports diesel or GPA, except that the ethanol products are far more expensive for the American consumer, and in this case, for the Pentagon?

Mr. BREEN. Well, sir, you mentioned fuel convoys which is a facet of life in a counter insurgency environment where you have isolated forward operating bases. This is one of the ways the military posture is different from our civilian posture. On those forward operating bases, we require——

Mr. GRIFFITH. So you are saying it is safer to do ethanol than it would be to do gas?

Mr. BREEN. No, sir, I am saying that we require liquid fuel, be it ethanol or whatever else, to fuel generators to generate the power on those bases, as well as to fuel the vehicles, so there is a huge push in the ground forces to move to solar, wind, and other renewable technologies. You don't have to move any kind of solid fuel.

Mr. GRIFFITH. So then your testimony about the Green Hornet would be slightly off. You are talking about going to some individual solar items, because——

Mr. BREEN. In the ground force, sir, but the Navy, for example, highly interested in making sure that it can use a diverse set of—the Navy wants to be sure that if the supply of liquid crude oil is disrupted for whatever reason, the Iranians close the straits, that the Navy, which is a huge liquid fuel user, can——

Mr. GRIFFITH. In the futures market—let me ask Mr. McNally, if the futures market was occupied solely by physical consumers of oil, what would the result be?

Mr. MCNALLY. The market wouldn't function because physical consumers of oil need to transfer price risk to those willing to take it, by definition, people who are willing to speculate, and if they

didn't have the speculators or financial market participants, the market wouldn't function. It would be much less efficient and prices would be more volatile.

Mr. GRIFFITH. And of course, a lot of us don't have natural gas that comes to our homes and we can't use it—I think Mr. Milburn, you testified that it wasn't good for trucking probably because there is not a supply network set up where you can stop and get more CNG. I know that in my neighborhood, even though I live in the largest city in the newly configured Ninth Congressional District of Virginia, I don't have natural gas coming to my house. Mr. Eichberger, who used to be a proud constituent of mine in the Ninth Congressional District of Virginia, used to live in the Reiner area, did you have natural gas in that county, which is the largest county in the Ninth District?

Mr. EICHBERGER. We were 100 percent electric.

Mr. GRIFFITH. Yes, which is based on my favorite, coal, in that area. You can't have electricity without coal, and that raises prices up. It just looks like to me that this administration has an "all of the above" policy to raise the cost of energy on all of the above.

Thank you, I yield back.

Mr. WHITFIELD. Thank you. At this time I recognize the gentleman from Pennsylvania, Mr. Doyle, for 5 minutes.

Mr. DOYLE. Thank you, Mr. Chairman.

I have been in Congress long enough that to see a hearing called "Rising Gas Prices," this is, you know, déjà vu all over again. We go through this from time to time, and sometimes listening to my friends talk about the Obama administration, I feel like I am living in an alternative universe, that somehow there is some magic wand that Newt Gingrich is going to wave and we are going to have $2.50 a gallon gasoline. I think it is time we just stop BS-ing the American people. In Pittsburgh, people I represent have highly refined BS meters, and they are going off loud and clear with all this talk about gasoline prices.

Can we just agree on one thing? A barrel of oil that is made—that is produced in Venezuela costs the same amount of a barrel of oil that comes out of the ground in Texas. It is a world commodity. We don't control the price. We don't control the price. People seem to think in this country that if you get oil out of American soil, that somehow we get a discount on it. Well is it not American's oil. Once an oil company buys that lease, it is Exxon's oil. It is their oil and they are going to sell it for the best price they can get it. Now that is just a fact of life, and if most of the price of a gallon of gasoline is the cost of the crude, then it is what it is going to be. It is a world market. People talk about natural gas. Natural gas isn't priced on the world market, OK? It is $2.50 at MCF here. That is not what it is selling for in other parts of the country, which is why we would like to export some of the excess natural gas so that there can be better profit margins and we have the supply to do that. But let us quit BS-ing the American people that there is some magic wand or some policy that Congress or any President, Democrat or Republican, can do to affect the price of a world priced commodity.

We were a net exporter of gasoline last year. The price of gasoline didn't go down. We can produce all the oil we want in this

country and all the cartel over there has to do is turn the spigot down a little bit and they will keep the price wherever they want to keep the price. So let us just quit BS-ing the American people that there is some way to control the price of a barrel of oil, and if we drill more in this country that somehow it gets cheaper. I mean, if you want to talk about let us not be dependent on buying it elsewhere and you want to increase the supply domestically, that is a valid statement. I mean, you can talk about that, but let us not talk about it in the context of prices of gasoline. We talk about the price of gasoline in Europe being $10 a gallon. They put taxes on top of their gasoline. The oil isn't more expensive over in Europe. They put tax on it so people will drive smaller cars. They use mass transit, they use trains. We built the interstate highway in America. We love our automobiles. OK, we are different than over in Europe. There is not going to be $10 a gallon gasoline in the United States of America. Just quit making the American people believe there is some fix to this.

This young man has hit the nail on the head. What they want from us and from the President is some vision and some leadership about the future. The future of our country is to get us off of this addiction to oil, to start to transition to natural gas vehicles and eventually to battery technology where we don't use any fossil fuel to power a car. When we got a battery that will take a car 400 miles before you have to recharge it, that is going to change the whole world. That is going to change our policy in the Middle East, and that is going to allow us to quit sending young men and women like Mr. Breen overseas to fight for all this oil that is so precious to us. That is what the American people want from us, some visionary leadership from their President and their Congress, not this constant BS that there is somehow you can make gasoline $2.50 a gallon before the presidential election in November.

So let us just quit this kind of talk and let us be real with the American people, and let us talk about how we invest in the future for our kids and our grandkids to make a difference. There is a Chinese proverb that says "The best time to plant a tree is 20 years ago. The next best time to plant a tree is today." What this Congress ought to be talking about is what we can do today for generations 20, 30, 40, 50 years from now so that our grandkids aren't sitting in a congressional hearing room having the same conversation that we had in 1970, that we had in 1980, that we had in 1990, when these prices start to fluctuate up and down. That is what the American people need from us.

Well, I just took 5 minutes on my soapbox, Mr. Chairman, and I am sorry about that. I would like one question, if one witness can answer.

I do have a concern about these refineries in Eastern Pennsylvania shutting down. Pittsburgh uses a special blend of gas in the summertime that is not made anywhere else that I am aware of, except at these three refineries near Philadelphia, and they are about to close. I would like to ask Mr. Drevna, the refinery person, is there any other refineries that make that kind of gas currently or is there a refinery that could ramp up to make that kind of gas to meet the needs of some of the communities in the Northeast, and specifically in Western Pennsylvania, that are going to be in

a bad situation if these three refineries in Eastern PA absolutely do shut down?

Mr. DREVNA. The answer to your question is no, there are no other refineries in an immediate area that can make the 7.2 pound gasoline. It is the summertime gasoline.

Now I understand just as recently as yesterday, Congressman Doyle, that Pennsylvania legislature passed a bill that would lift that 7.2 and go to a 9.0 RBP. It wouldn't be summer gasoline. I understand the governor might—probably will sign that. Now problem being is EPA is going to have to bless it, and that—the reason why there is that gasoline there is that Pittsburgh, my hometown, by the way, would—did not need to go all the way to the more and more expensive RFG, reformulated gasoline. So over time, it was a better deal for the folks in Western Pennsylvania. You are right, with the unfortunate shutdown of those refineries and all the heartache that comes with it, but I—if we can start now, because we have got to get that stuff into the pipeline by, you know, probably May so if we could start now and get EPA to help the State of Pennsylvania, to help those refineries in Ohio and West Virginia to get that gasoline there, it will be fine.

Mr. WHITFIELD. At this time I recognize the gentleman from Louisiana, Mr. Scalise, for 5 minutes.

Mr. SCALISE. Thank you, Mr. Chairman. I appreciate you having this hearing on the rising price of gasoline. I know it is a concern of many not only constituents of mine, but of my colleagues all across the country. It is a problem that is facing many families that are holding them back from being able to do the things that they do to enjoy the quality of life that they had. It is hurting our job creators in the abilities that they have to hire more people in this country, and yet, when we look at why we got here, there are some people that just want to act like policy has nothing to do with it, like supply and demand doesn't exist in a free market.

And so, you know, what I first want to point out is those of us that have supported an "all of the above" energy strategy for a long time and this House has passed many bills—in fact, Mr. Chairman, you brought a number of those bills through this subcommittee that we have passed through the House and are sitting in the Senate that would increase the supply, not just of oil, of natural gas, coal, nuclear power, and yes, wind and solar as well. But addressing each of those in a realistic way that allows America to utilize our energy resources that are here that are currently blocked by Federal policy. And you know, for people to just ignore that when the President shuts down supply, that somehow that has no effect on cost, then maybe they didn't take basic economics. But it absolutely does, and I know a few of our panelists have talked about this.

I want to start by going through the record, and let us just talk about where we are with gas prices and look at the statements that the President himself made. You know, back in 2008 Barack Obama said that he would prefer a "gradual adjustment to near $4 a gallon gasoline." President Obama said this. He said it when gasoline was about $1.80 a gallon. The President got his wish. He asked for $4 a gallon gasoline. He said he wanted it. He has implemented policies to get us there, and now that the price is there and

people across the country are furious with the price, the President is trying to blame somebody else, and it is some speculator. You know, we don't—we need to open up the Strategic Petroleum Reserve or the President is the most energy-producing President in history. It is a disingenuous statement when you look at the fact that oil production on Federal lands is actually down, down by more than 10 percent. Lands where the President actually has control through his regulators, that production is down. Where it is up is on private lands and many States like North Dakota where they have used hydraulic fracturing and new technologies to get oil in other areas, and the President is trying to shut that down, too, ironically. So on one hand, he is trying to take credit for something that he has no control over, but he is trying to control it through the EPA and shut it down. Fortunately, he hasn't been successful and in fact, we passed legislation to block the EPA from shutting it down. The President's own energy secretary, the President's own energy secretary says "Somehow we have to figure out how to boost the price of gasoline to the levels in Europe." Well, he figured it out and we are getting there. And people are furious with the high price that they imposed. The Obama administration did this. I mean, you can look at the price of gasoline and you can track that the President has gotten what he wanted. It is just now he is getting the heat for it. People are furious that the President got his wish of $4 a gallon gasoline that we are approaching, and so now he is trying to shift the blame.

But look at the record. The permatorium in the Gulf of Mexico, we have seen it directly in Southeast Louisiana. After the Deepwater Horizon explosion, the President imposed a moratorium on drilling that actually went against the advice of his own handpicked safety experts. The President's handpicked experts said don't impose a moratorium, it will actually decrease safety in the Gulf. And what happened? The President did it anyway and still to this day, there is a permatorium where it is almost impossible to know what the rules are to get a permit. So what happened? We have seen a dozen deepwater rigs leave not only the Gulf of Mexico, leave the country. Over 12,000 jobs, American jobs have left the country because of that one decision by President Obama that went against the advice of his own safety experts. So how is that policy working out? Look at lease sales. In the President's lease sales that he recently issued, over 50 percent of the Federal lands that were getting ready to come open for exploration are closed now by President Obama, and the price keeps going up. If you look at Keystone XL, we were going to be able to get a million barrels of oil a day from a friend. Canada is a great friend of America, great trading relationship. The President said no, not only to that Canadian oil that now we wouldn't have to get from these Middle Eastern countries who don't like us or Venezuela, but he said no to 20,000 jobs. China wants the oil, so China is going to get the oil because President Obama said no. And the price keeps going up.

And you wonder, after all of these things happen, what is their answer? The President's latest answer now, it looks like they are going to try to go down that road of tapping a Strategic Petroleum Reserve again. When they tried it the last time it didn't work. It

is there for national emergencies. The Strategic Petroleum Reserve is not a bailout fund for President Obama's failed policies.

So Mr. Gerard, I know you had given some good comments on this. If I could just get your take, you know, as you talked about how markets drive expectation. As all of these policies that President Obama to shut off so many areas of Federal energy have now taken an impact. Has that had an impact on price?

Mr. GERARD. Absolutely. The market is driven by expectation and there tends to be a lot of focus here, particularly today on the Middle East question and Iran and the Straits of Harmuz. The reality is that global demand coming out of China, India, and elsewhere, but the rest of the world also looks at the United States. When they see policies, they understand the vast resources we are sitting on, but when the policies fundamentally discourage those and there is no expectation in the marketplace that we are ever going to bring serious production to bear, and that all gets accounted into the price. So today, one of the reasons the price is being driven up is a lot of people believe that the United States won't take action. That is why we said if we call on the President to send a strong signal, we are not going to let this happen. We hear a lot of talk about well, let us quit talking about drilling for oil. We have been 40 years in the country and we haven't had a policy of drilling for oil. Why don't we try it once? We have tried everything else. Let us produce our own resource. Let us do it by Americans for Americans. It is in a global marketplace. The price is determined by the price of crude oil. But we put crude oil into the marketplace and it has downward pressure on that price. It is pretty fundamental, it is Economics 101, and we just can't seem to get ourselves there.

Mr. SCALISE. Thank you. I yield back, Mr. Chairman.

Mr. WHITFIELD. At this time I recognize the gentleman from New York, Mr. Engel, for 5 minutes.

Mr. ENGEL. Thank you. Thank you very much, Mr. Chairman. I listened to a lot. You know, it is such nonsense to try to point the finger politically at the President of the United States and say that there is rising gasoline prices because of him. As some of our colleagues pointed out before, you could look at when President Bush first came to office and when he left, and prices doubled and tripled and quadrupled. So it is just nonsense. Everybody knows that there are all kinds of pulls and tugs in China and India and other countries forcing things, changing the prices because of it. You know, we can tinker at the edges and we can try our best and we can do it from our different perspectives, but to say it is the President's policies is just poppycock, as far as I am concerned.

I would rather focus on a few bipartisan things. Our colleague, Congressman Shimkus, earlier mentioned our bill, his bill and my bill, the Open Fuel Standard, H.R. 1687, which requires new automobiles to be alternative vehicles capable of operating on another fuel in addition to or instead of gasoline. Any type of fuel would qualify, natural gas, electricity, biodiesel, hydrogen, alcohol-based fuels, or anything else. And the beauty of this bill, which I have been sponsoring for a number of years, is that it would open up the marketplace so that other fuels could compete with gasoline. Any other fuel on the market can decide. When I was in Brazil, when

you pull up to a refueling station you can choose to put methanol, ethanol, or gasoline into your vehicle. It is competition. Competition helps drive down prices. You can base that choice on cost or whether the fuel is produced domestically, or whatever criteria the consumer chooses. So I think we should have a similar choice. We could have flex fuel vehicles in this country for $100 or less per car, and I think is it criminal that we are not doing it. So that is what the Open Fuel Standard Act would provide, it would provide a choice.

I would like permission to submit for the record two studies. One is the interdisciplinary study from the Massachusetts Institute of Technology called "The Future of Natural Gas" from June 9, 2011, which finds that the conversion of natural gas to methanol would provide a cost effective route to manufacturing an alternative or supplement to gasoline. Methanol can also be produced from other fossil fuels or from renewable resources such as agricultural products, municipal waste, and biomass. And I would also like to submit for the record a CAN report entitled "Ensuring America's Freedom of Movement: A National Security Imperative to Reduce U.S. Oil Dependence," October of 2011, which notes that a light duty triflex fuel vehicle running on methanol, ethanol, and gasoline would be an effective and cost efficient way that could greatly reduce our dependence on foreign oil.

[The information is available at http://mitei.mit.edu/system/files/NaturalGas__Report.pdf and http://www.cna.org/sites/default/files/MAB4.pdf]

I also want to note that the 2012 Work Truck Show is going on in Indianapolis just this week. General Motors is introducing two new bi-fuel compressed natural gas and regular petroleum gas-powered trucks, the 2013 Chevrolet Silverado and the 2013 GMC Sierra 2500 HD. Both of these vehicles can burn either fuel, and GM promises that the on-the-go switch between the different fuel types is seamless. I really want to mention that.

I also would like to ask a couple of quick questions on behalf of the travel and tourism industry. The impact of rising gasoline prices is really felt by industries like the travel and tourism industry. It is enormously sensitive to high gas and energy prices. I am wondering if some of the panelists can comment on that. Fifty cents rising in gasoline since December; the estimates are that a 50-cent increase in gasoline prices in 1 year translates to a $70 billion impact on the economy as a whole, so I would like any one of the panelists to comment on that, and also to comment—we have tinkered around the Strategic Petroleum Reserve and the risk of opening it up to address the problem now. I would like anyone who cares to comment on this.

Mr. MILBURN. Mr. Engel, in the trucking industry our diesel fuel costs have a direct impact every day on the whole economy. We are transporting goods and materials across this country every day. You weren't here for my opening testimony, but the regulations regarding the new fuels is going to add $6,200 to the cost of a new vehicle for me. With the increase in fuel, I cannot afford to keep putting back money to replace my truck, which is currently 3 years old and has over half a million miles on it, by 2014 with the new standards that the EPA is requesting. But when I am out here

every day driving and transporting goods and services, it has a direct effect upon the economy and raising inflation and the cost of everything we do out here. The suit you are wearing, the car you are driving, we all haul it.

Mr. ENGEL. Let me just—I know I am running out of time. Mr. Milburn had his hand up.

Mr. WEISS. Thank you, and your question about the Strategic Petroleum Reserve——

Mr. ENGEL. Weiss, I am sorry.

Mr. WEISS. That is OK. I knew who you meant. I know we are both very good-looking fellows, so it easy to mix us up.

There was a misstatement made earlier. In fact, the price of oil dropped 17 percent from the day that the President announced the sale on June 23 to the day that the last barrel of oil was sold on September 30, and the price of gasoline dropped almost 6 percent during that same time, or about 25 cents a gallon. So in fact, selling 30 million barrels of oil last year of our reserves and 30 million barrels of our ally's reserve, putting that on the market did actually reduce prices during that time.

Mr. DREVNA. Mr. Engel, thank you. As comment on that, yes, the 30 million barrels we put out in that little bit of timeframe was about 9 hours worth of oil on the global market. Imagine what would happen if we opened up more resources, if we got off the 60 percent of imported oil that we are now to use our own and use Canada's. That is number one.

Number two, you talked about your free choice—your free fuel, free car act. It would be free if we—if the refiners weren't obligated parties to a mandate. So you can't say something is free if we are mandated to use 36 billion gallons of non-free kinds of fuels. So we would be more than willing to talk to you about how this would work, but let us keep the consumer in mind and let us keep the free market in mind. So if we are going to do something that is based on a free market, let us have free market in competition, and it ultimately will help the consumer.

Mr. WHITFIELD. Gentleman's time is expired. At this time I recognize the gentleman from Oklahoma, Mr. Sullivan, for 5 minutes.

Mr. SULLIVAN. Thank you, Mr. Chairman, and my first question is to Mr. Gerard.

Mr. Gerard, the President stated in the State of the Union address, he called for increased American made energy resources. But as we know, actions speak louder than words. At the same time, he is calling for more oil and gas. His administration has 10 different Federal agencies considering ways to overregulate hydraulic fracturing, the process we use to get tight oil and natural gas out of the ground. Some of these agencies looking to potentially take hydraulic fracturing regulation from the States, where it belongs, including the Department of Energy, EPA, and the Department of Interior. Do you have any concerns that this administration will make hydraulic fracturing economically prohibitive to drill oil on both public and private lands, and can you go into how hydraulic fracturing can increase the supply of oil in America?

Mr. GERARD. Yes, we are very concerned by what is going on at the Federal level. As you know, hydraulic fracturing has been around for 60 years. We have drilled over a million wells with this

technology. We have improved it greatly. The technology is advanced. And today—and going back to Mr. Engel's point earlier when he was talking about natural gas vehicles, all that is made possible in the United States today because of the vast supply of natural gas. It is a game changer. It literally changes the energy equation in this country, so we are very concerned about what we see going on within the administration.

A week or so ago EPA Administrator Jackson commented, she said well, the States are doing a good job of regulating. Well, they have been there for many, many years. The governors think they are protecting their land, their water and their people very well. Our greatest concern is the Federal Government is now going to come in and overlay yet another layer of regulation to duplicate, conflict, or to crank down our ability to produce these vast resources here in the United States.

As you mentioned today, there are 10 Federal agencies looking to regulate natural gas. Now we have got the Center for Disease Control, we have got the Army Corps of Engineers, we have got the Department of Agriculture. All these you probably haven't thought of before are looking to regulate hydraulic fracturing in one way or another. So it is a very serious consideration.

The other thing I would add, in talking to governors around this country, those in North Dakota, Pennsylvania, and elsewhere that have seen this vast change, in the last 18 months we have created 83,000 jobs in the State of Pennsylvania as a result of these newfound preferred technologies to produce natural gas. Governors are very worried the Federal Government is going to come in and overlay another level of regulation that will discourage this production. Over the next 5 years, if we are not allowed to use natural gas, it will by and large take off the table 45 percent of our gas production, 17 percent of our oil production by stopping the use of that proven technology.

Mr. SULLIVAN. And you mentioned that we have done fracking for 60-some odd years. I believe there are probably over a million fracks, I believe.

Has there ever been one instance, Mr. Gerard, that you can point to that it has ever gotten into groundwater?

Mr. GERARD. There are zero confirmed cases of groundwater contamination after 60 years of hydraulic fracturing over a million wells.

Mr. SULLIVAN. Why do you think that we have done it for—it is not a new technology. We have done it for a long time. Why all the sudden all this talk about it is so bad?

Mr. GERARD. Well it tends to be heavily driven by those who would prefer to move us off of fossil fuels and specifically off of natural gas and oil.

Mr. SULLIVAN. Thank you very much.

Mr. Drevna, my next question is for you. President Obama's Executive Order 13563 required agencies to look for existing regulations that could be streamlined or repealed. Has EPA done this for refinery regulations? This is a three-part question. The Executive Order also requires agencies to look at the cumulative burden of regulations, which would seem particularly important for refiners which have been subject to a very long list of EPA measures. Has

EPA looked at the cumulative burden on refineries? The Executive Order also urges agencies to take pains to minimize the cost of new rules and ensure that the benefits justify the costs. Do you see evidence of this at the EPA?

Mr. DREVNA. In short order of the three questions, no, no, and no.

Now if I may be permitted to expand upon that somewhat, not only have they not, you know, looked at regulations that have impacted refiners and ultimately the consumer, which I think this hearing—I hope this hearing is about, it is the fact that they are giving us conflicting regulations. They are piling more on. I mean, you look at what we have to do, Congressman, on the Renewable Fuel Standard, so we are blending more and more in and we are at a point now where we are going to have to make a decision. Do we comply with ISA 07, or do we protect the consumer?

And then we are asked to lower—I mean, to have better CAFE standards. That is a good thing, but so we are blending more stuff into gasoline that gets less mileage. And then we are asked to take more sulfur out that increases—at a cost, and then we are going to increase CO2. So you wonder why we are, you know, running around in circles as refiners. Just say wait a minute, has anyone gotten out of their own little vacuum here and looked at the overall impact of all these regs and how they are conflicting?

And just to go back a little in history, I testified in 2008 in February—I mean, the ink wasn't dry on ISO 07 that Senator Bingaman was holding a hearing on oversight on that bill, and you know, of course Tier 3 wasn't on the table at that time, but at that time we testified and we said Senator, which one of these bills, which one of these things do you want us to comply with? And then now we have EPA talking about well, it is OK to use E–15 in automobiles, except the automobile folks are saying oh, no way. We are not going to warranty those. It is OK to use, you know—we have to blend nine million gallons of something called cellulosic ethanol that doesn't exist, you know, and you wonder why refineries are scratching their heads right now, and that—so the answer is no. We need the EPA to really take a long, hard look at what the President said and act in earnest to try to work with us to figure out a path forward out of this thing. Right now we keep running into brick walls.

Mr. SULLIVAN. Thank you very much.

Mr. WHITFIELD. The gentleman's time is expired. At this time I recognize the gentleman from Colorado, Mr. Gardner, for 5 minutes.

Mr. GARDNER. Thank you, Mr. Chairman, for holding this hearing today, and thank you as well to the witnesses for their time and thoughtful comments.

Just a couple of questions. I heard Mr. Weiss say that the Strategic Petroleum Reserve had an impact on price, and I can't help but thinking the minority leader has talked about increasing—you know, tapping or drawing down the Strategic Petroleum Reserve. We have heard others say that they want to tap into the Strategic Petroleum Reserve. Now my guess is that is for a very simple reason. People would tap into the Strategic Petroleum Reserve because of supply and because of price, and the economic argument

says that if you increase supply, if you increase the amount of oil that comes out of the Strategic Petroleum Reserve, then it has an impact on price. It was said here at this committee hearing, that it impacted price. Well that in itself is an argument for increased supply. So all this argument that supply doesn't matter is defeated by the argument that the Strategic Petroleum Reserve had an impact on price.

So the answer is before us. If we increase domestic supply, then it will impact price and it will reduce the price, just as the tap of the Strategic Petroleum Reserve did, so that is pretty obvious.

Mr. McNally, is that an incorrect analysis?

Mr. MCNALLY. No, you are right. Increasing supply does reduce the price. In the case of the SPR, though, it bought us 4 days in 2011, and we did a little better in 2000 when 60 days before the election, President Clinton invited Al Gore to announce a stock draw, over the objections of his Treasury Secretary and the Federal Reserve chairman. That was a little better, that was 12 days, but it is short-term. What we really need is to increase production and supply over the long term. That will have a permanent effect.

Mr. GARDNER. And because as the Strategic Petroleum Reserve drawdown suggested, supply had an impact on price.

Mr. MCNALLY. Correct.

Mr. GARDNER. And so if you have more supply available in the United States, whether it is domestic drilling, whether it is the Keystone XL pipeline, whether it is using the oil developed through Niobrara oil formations in Colorado, that increases supply and will have an impact on price.

Mr. MCNALLY. Correct.

Mr. GARDNER. Thank you. And so the question I have then is do you think it is wise to access the Strategic Petroleum Reserve now or increase our domestic supply?

Mr. MCNALLY. I think—well, it is better to increase our domestic supply for the long term, but as we have been saying, there is no short-term solution to the prices we have right now. It would have been nice to have had the 700,000 barrels a day that would have flown to our Gulf refineries through Keystone by now, because we could have said to our Saudi friends, our Kuwaiti friends, we don't need that 700,000 barrels a day, please send it to China and India, because we are asking them to lower their imports of Iranian crude. That would be nice, but we can't fix that overnight.

Mr. WEISS. Mr. Gardner, can I address that since, you——

Mr. GARDNER. Actually I have a couple of questions for Mr. McNally. Thank you.

What are the signs of true market manipulation by speculators, and then just a follow up question to that, historical examples that exist in oil companies or oil and other commodities?

Mr. MCNALLY. Traditionally in order for speculators to distort prices, they have to manipulate or hoard physical supply. There have been cases in the past, Mark Rich, et cetera, where physical people bought the actual commodity, hid it somewhere, took it off the market, and then went along the futures and squeezed people, and we police very carefully for that. There was no evidence anywhere that we saw a hoarding of inventory or some indication that either OPEC or some private company was hoarding oil prices were

rising—as oil prices were rising into 2008 and even now, as I mentioned, inventories are actually very low and spare capacity is tight. It is the absence of inventory hoarding which I think convinces the independent unbiased experts have looked at this, including myself as a private market analyst, that there is no distortion going on.

Mr. GARDNER. Thank you.

Mr. Milburn, a couple of questions for you. You mentioned talking about some of the regulations and the impact those regulations are having on the price of diesel. They have increased the price of diesel fuel, is that correct?

Mr. MILBURN. Significantly.

Mr. GARDNER. And you are not able to get as many miles as you were per gallon of diesel because of regulations?

Mr. MILBURN. No, sir. Prior to the advent of the ultra low sulfur diesel, which I talked about earlier, the trucks were actually getting better fuel mileage. The ultra low sulfur diesel has reduced the lubricity of the diesel, causing, you know, more wear and tear on the engines, and yet we are talking about going to compressed natural gas for a future energy source, but we are not there yet. That compressed natural gas engine for Class A trucks is going to be able to do the job hauling, in your State of Colorado, up the Rocky Mountains. We are going to need the power.

Mr. GARDNER. And Mr. Milburn, are you using—if there was something else available that was as affordable—actually less cost than gasoline or diesel that was equally available, that you could go to any convenience store and find, would you use that?

Mr. MILBURN. If it——

Mr. GARDNER. If it was efficient for your——

Mr. MILBURN. If it was efficient for my trucking operation, yes, I would.

Mr. GARDNER. And so you are not just using oil for the sake of using oil?

Mr. MILBURN. No, sir. You know, OOIDA's position is that we want to see further use——

Mr. GARDNER. But it is the most economical thing that you have right now, which——

Mr. MILBURN. It is right now.

Mr. GARDNER [continuing]. Is why we need to——

Mr. MILBURN. Plus the compressed natural gas stations are not en route. There is one in Baytown, Texas. That is the only one that I know of at this point, is in Baytown, Texas, for commercial trucks.

Mr. GARDNER. Mr. McNally, if I could ask you one final question. The Rocky Mountain region, we have seen consumers paying 50 to 54 cents less per gallon in the Rocky Mountain region because of the availability of West Texas Intermediate. What would happen if others had—you know, I guess what I am asking is how—if we had a better balance of West Texas Intermediate or of some of the supplies, what would happen around the country?

Mr. MCNALLY. The Energy Information Administration has noted because the Rocky Mountains, what we call Pad 4, is relatively self sufficient in refining, it has been able to enjoy the lower crude prices and have lower gallon gasoline prices. Everywhere else

though in the Midwest, consumers are not enjoying the benefit of the glutted crude. Refiners who are in the Midwest are unable to gorge on low price crude and so world gasoline prices are doing very well. Canadian producers and U.S. producers, not so well, but American consumers outside of the Rocky Mountain region really haven't seen any benefit, and when that distortion is removed and that oil flows, they won't see prices——

Mr. GARDNER. So once again, a supply issue?

Mr. MCNALLY. Yes, sir.

Mr. GARDNER. Thank you.

Mr. WHITFIELD. Thank you. Well, that——

Mr. RUSH. Mr. Chairman?

Mr. WHITFIELD. Yes?

Mr. RUSH. Mr. Chairman, I have a unanimous consent request. One, that I have two letters here that I spoke of in my opening statement. One is to the chairman of the Commodities Futures Trading Commission dated March 1, 2012. It was sent by me to Chairman Gensler. I want that introduced into the record. I request unanimous consent that that be introduced into the record.

Mr. WHITFIELD. Without objection.

Mr. RUSH. The second is a bicameral letter dated March 5, 2012, to the entire Commission, and I would like that introduced into the record.

Mr. WHITFIELD. Without objection.

[The information follows:]

BOBBY L. RUSH
1ST DISTRICT, ILLINOIS

COMMITTEE ON ENERGY AND COMMERCE
SUBCOMMITTEES:
RANKING MEMBER, ENERGY AND POWER
COMMERCE, MANUFACTURING AND TRADE
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STEERING AND POLICY COMMITTEE

March 1, 2012

The Honorable Gary Gensler
Chairman
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Dear Chairman Gensler:

I am writing to voice my concern over the prospect of excessive speculation by Wall Street traders, which may be artificially raising the price of gasoline. After reading an *ABC News* article entitled "*How Wall Street Is Raising the Price of Gas*" dated February 23, 2012, I am requesting that the Commodity Futures Trading Commission (CFTC) initiate an investigation into the practices of speculators and the subsequent role that this practice has on gas prices that consumers pay at the pump.

Every year Americans experience a rise in gasoline prices as summer approaches and we head into the heaviest driving season. However, this year gasoline prices have risen much faster and far earlier than in previous years. In fact, as of Wednesday, February 29th gas prices have increased for the 22nd consecutive day, while research shows that Americans are using less fuel.

An article by the *Washington Post with Bloomberg Business* entitled "*Gas Prices Rise for 22nd Straight Day; Oil Recovers Late to Close Above $107 a Barrel*" (Feb. 29, 2012) reports that Americans are currently paying an average price of $3.73 a gallon for regular gasoline, which is 30 cents higher than it was just last month and 36 cents higher than this time last year. This news comes just as the Department of Energy reports that average demand decreased last week by 6.2 percent and overall gasoline demand has dropped 6.7 percent as compared to the same time last year.

While I understand that there are many geopolitical factors that affect fuel prices, I also feel that it is imperative that we better understand the role that speculation plays in impacting the price at the pump. As officials who have been chosen to protect consumers, it is important that we examine this issue and demonstrate to the public that we are doing everything in our power to address this pressing concern, which affects every American family.

Please follow up on this issue with my Senior Policy Advisor, John Marshall, who can be reached at (202)225-4372 or JohnM@mail.house.gov. Thank you for your attention and I look forward to your prompt reply to this critical matter.

Sincerely,

Bobby L. Rush
Member of Congress

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Congress of the United States
Washington, DC 20510

March 5, 2012

The Honorable Gary Gensler
Chairman
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

The Honorable Bart Chilton
Commissioner
Commodity Futures Trading Commission
Three Lafayette Centre
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The Honorable Mark Wetjen
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The Honorable Jill Sommers
Commissioner
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The Honorable Scott O'Malia
Commissioner
Commodity Futures Trading Commission
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1155 21st Street, NW
Washington, DC 20581

Dear Chairman Gensler, and Commissioners Chilton, Wetjen, Sommers, and O'Malia:

We are writing to urge you to immediately enact strong position limits to eliminate excessive oil speculation as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. As you know, the Dodd-Frank Act mandated that your agency promulgate and enforce such limits no later than January 17, 2011. We are disappointed that, more than a year later, the Commission has not fulfilled this important regulatory duty.

Congress determined that speculative position limits are an effective and critically important tool to address excessive speculation in America's oil and gasoline markets. It is one of your primary duties--indeed, perhaps your most important--to ensure that the prices Americans pay for gasoline and heating oil are fair, and that the markets in which prices are discovered operate free from fraud, abuse, and manipulation.

There has been a major debate over the last several years as to whether spikes in oil prices are caused entirely by the fundamentals of supply and demand or whether excessive speculation in the oil futures market is playing a major role. It is clear to us that debate has ended. Exxon Mobil, Goldman Sachs, the Saudi Arabian government, the American Trucking Association, Delta Airlines, the Petroleum Marketers Association of America, and even a report last year from the St. Louis Federal Reserve have all indicated that excessive oil speculation significantly increases oil and gasoline prices. According to a February 27, 2012

article in *Forbes*, excessive oil speculation "translates out into a premium for gasoline at the pump of $.56 a gallon" based on a recent report from Goldman Sachs.

The facts bear this out. According to the Energy Information Administration, the supply of oil and gasoline is higher today than it was three years ago, when the national average price for a gallon of gasoline was just $1.90. And, while the national average price of gasoline is now over $3.70 a gallon, the demand for oil in the U.S. is at its lowest level since April of 1997. Nor is the global supply of oil at issue. According to the International Energy Agency, in the last quarter of 2011 the world oil supply rose by 1.3 million barrels per day while demand only increased by 0.7 million barrels per day. Yet, during this same period, the price of Texas light sweet crude rose by over 12%. Meanwhile, oil speculators now control over 80 percent of the energy futures market, a figure that has more than doubled over the past decade.

As the cost for American people to fill their gas tanks continues to skyrocket, the CFTC continues to drag its feet on imposing strict speculation limits to eliminate, prevent, or diminish excessive oil speculation as required by the Dodd-Frank Act. Although the CFTC has adopted initial position limits, they are not strong enough and not yet in force owing to industry opposition, delays in swaps oversight and data collection. This is simply unacceptable and must change.

We urge you to take immediate action to impose strong and meaningful position limits, and to utilize all authorities available to you to make sure that the price of oil and gasoline reflects the fundamentals of supply and demand. This could entail promulgation of rules only with regard to the currently regulated exchange markets. Swaps rules should also be implemented immediately, but even so, waiting for swaps rules to trigger all position limits is simply not adequate to protect consumers. We urge you to develop alternative methods of moving forward and to do so as swiftly and expeditiously as possible.

We have a responsibility to ensure that the price of oil is no longer allowed to be driven up by the same Wall Street speculators who caused the devastating recession that working families are now experiencing. That means that the CFTC must do what the law mandates and end excessive oil speculation once and for all.

Thank you for your attention to this important matter. We look forward to receiving your response.

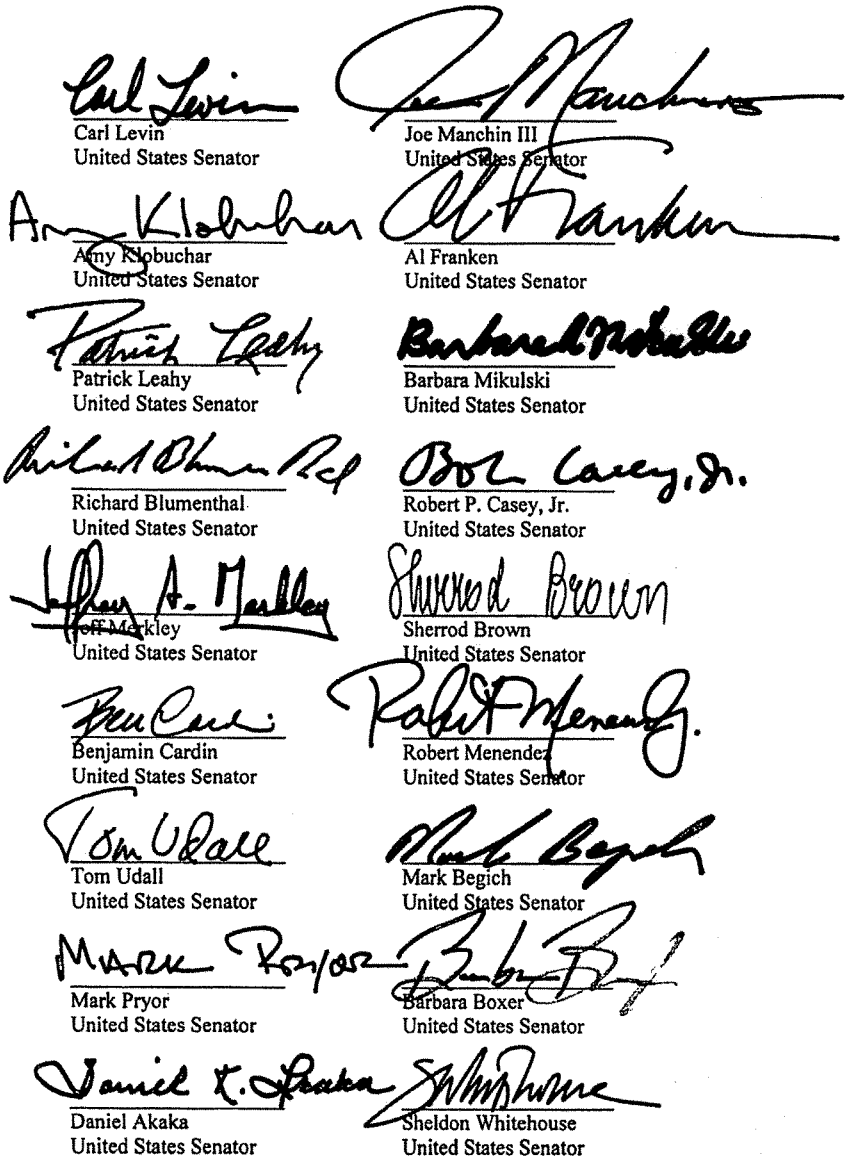
Sincerely,

Bernard Sanders
United States Senator

Bill Nelson
United States Senator

Ron Wyden
United States Senator

John D. Rockefeller IV
United States Senator



Carl Levin
United States Senator

Joe Manchin III
United States Senator

Amy Klobuchar
United States Senator

Al Franken
United States Senator

Patrick Leahy
United States Senator

Barbara Mikulski
United States Senator

Richard Blumenthal
United States Senator

Robert P. Casey, Jr.
United States Senator

Jeff Merkley
United States Senator

Sherrod Brown
United States Senator

Benjamin Cardin
United States Senator

Robert Menendez
United States Senator

Tom Udall
United States Senator

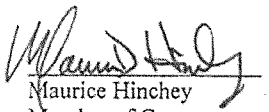
Mark Begich
United States Senator

Mark Pryor
United States Senator

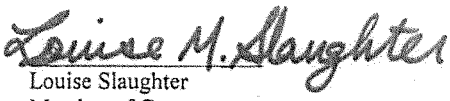
Barbara Boxer
United States Senator

Daniel Akaka
United States Senator

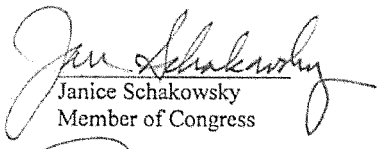
Sheldon Whitehouse
United States Senator



Maurice Hinchey
Member of Congress



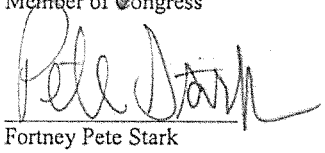
Louise Slaughter
Member of Congress



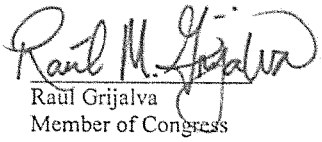
Janice Schakowsky
Member of Congress

Peter DeFazio
Member of Congress

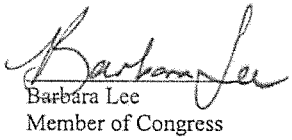
Peter Welch
Member of Congress



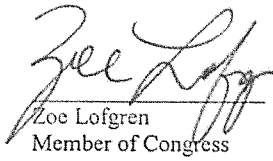
Fortney Pete Stark
Member of Congress



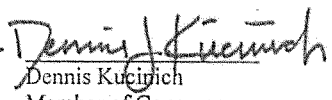
Raúl Grijalva
Member of Congress



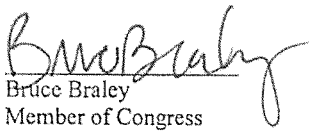
Barbara Lee
Member of Congress



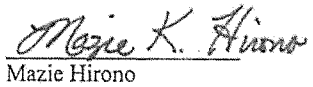
Zoe Lofgren
Member of Congress



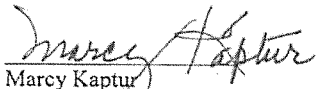
Dennis Kucinich
Member of Congress



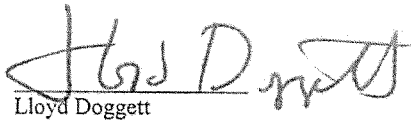
Bruce Braley
Member of Congress



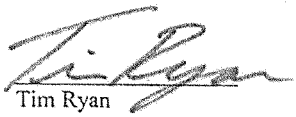
Mazie Hirono
Member of Congress



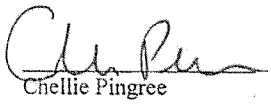
Marcy Kaptur
Member of Congress



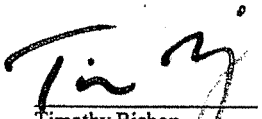
Lloyd Doggett
Member of Congress



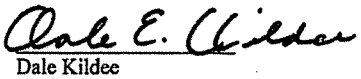
Tim Ryan
Member of Congress



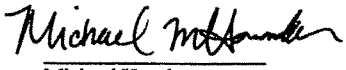
Chellie Pingree
Member of Congress



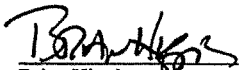
Timothy Bishop
Member of Congress



Dale Kildee
Member of Congress



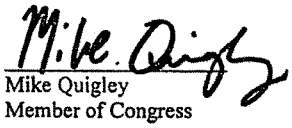
Michael Honda
Member of Congress



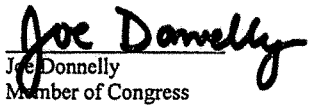
Brian Higgins
Member of Congress

Paul Tonko
Member of Congress

Leonard Boswell
Member of Congress

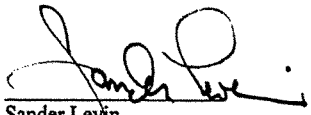


Mike Quigley
Member of Congress

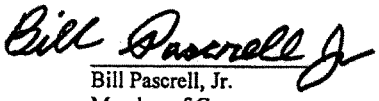


Joe Donnelly
Member of Congress

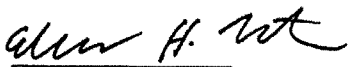
Bob Filner
Member of Congress



Sander Levin
Member of Congress

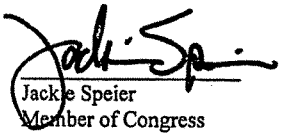


Bill Pascrell, Jr.
Member of Congress

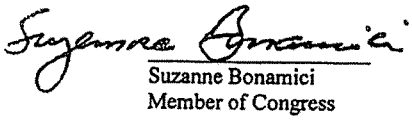


Eleanor Holmes Norton
Member of Congress

Bobby Rush
Member of Congress



Jackie Speier
Member of Congress



Suzanne Bonamici
Member of Congress

Nick Rahall
Member of Congress

Anna Eshoo
Member of Congress

John Tierney
Member of Congress

Michael Michaud
Member of Congress

Henry C. "Hank" Johnson
Member of Congress

John Lewis
Member of Congress

John Olver
Member of Congress

Gerald E. "Gerry" Connolly
Member of Congress

Rosa DeLauro
Member of Congress

Jim McDermott
Member of Congress

John Conyers, Jr.
Member of Congress

Marcia Fudge
Member of Congress

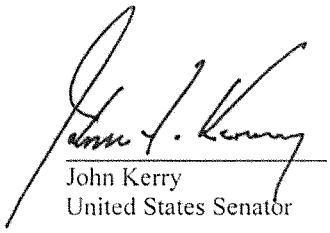
Gary Ackerman
Member of Congress

David Cicilline
Member of Congress

Jack Reed
United States Senator

Lucille Roybal-Allard
Member of Congress

Tammy Baldwin
Member of Congress



John Kerry
United States Senator

Mr. RUSH. My last unanimous consent request is that Mr. Weiss indicated that he had—he indicated in his testimony or during his testimony that there was a report, a 2009 report by the Commodities Futures Trading Commission. I would like to, of course, through the Chair, get that and have that entered into the record, and any additional reports that you might have also, to get those introduced into the record.

Mr. WHITFIELD. Without objection. Does anyone else have a document they would like to submit for the record?

Well that concludes today's hearing, but we will keep the record open for 10 days in case someone feels moved to submit additional information. I want to thank all of you for taking time to be with us today to explore this important issue of gasoline prices and the impact on our economy.

And with that, the hearing is concluded. Thank you.

[Whereupon, at 1:30 p.m., the subcommittee was adjourned.]

[Material submitted for inclusion in the record follows:]

March 7, 2012

Statement for the Record of Congressman John Sullivan
House Energy and Power Subcommittee hearing on
The American Energy Initiative- Gas prices

Chairman Whitfield:

Thank you for holding this critical hearing on gas prices.

Every community I visit in my district is concerned about rising gasoline prices – especially with the summer travel season right around the corner.

According to AAA, the average gasoline prices has increased or stayed the same for 39 consecutive days. The sad fact is that that gas prices have risen a whopping 83% since President Obama took office. It is evident that his Administration has no plan for energy security and they continue to ignore the severity of our addiction to foreign oil.

Our nation spends at least $1 billion per day overseas for foreign oil - when the fact of the matter is that that we have ample oil and gas resources here in our own backyard. With rising gasoline prices, it is in both of our economic and national security interests to remove regulatory barriers that will increase our supply of oil right here at home.

Unfortunately, the Obama Administration has taken four specific actions - just in the last few weeks - that will result in price of gas to continue to rise even further and lead to greater uncertainty in the world oil markets.

- **1)** President Obama rejected the House passed Keystone XL pipeline - he had 3 years to approve it, but caved to the left wing environmentalists who don't want it. Now 700 thousand barrels of North American oil sits on the sidelines, putting U.S. energy security at risk.

- **2)** President Obama's budget proposal rolled out last month unfairly targets oil and gas producers with billions in punitive tax increases.

- **3)** Last month, President Obama announced his plan for tax reform, which skews the tax code to further punish American oil and gas producers.

- **4)** The Obama Administration has ten different federal agencies considering ways to over regulate hydraulic fracturing, a process we use to get oil and natural gas out of the ground. Their actions will potentially make exploration for oil and natural gas economically prohibitive on both public and private lands.

While the Obama Administration continues to turn their back on jobs and energy security, I will keep supporting legislation that will grow our economy and alleviate the pain at the pump for

American consumers.
Three weeks ago, the House passed the Protecting Investment in Oil Shale the Next Generation of Environmental, Energy, and Resource Security Act (The PIONEERS Act).

Simply put, this bill accomplishes two goals: It approves the privately funded Keystone XL pipeline AND it will create over 1 million jobs by removing government barriers that block production of American made energy resources by forcing the Obama Administration to move forward with new offshore and onshore energy production in areas like the Arctic National Wildlife Refuge (ANWR) in Alaska, and on federal lands and waters. I call on the Senate and President Obama to support this common sense energy legislation.

I am pleased to see the diverse set of witnesses here today to talk about how they are working to increase American oil production in spite of the Obama Administration's regulatory actions to curtail it, and to discuss solutions we can take to increase American energy security.

I yield back the balance of my time